

FUTURE OF UNIVERSAL SERVICE

HEARING

BEFORE THE

SUBCOMMITTEE ON COMMUNICATIONS

OF THE

COMMITTEE ON COMMERCE, SCIENCE, AND TRANSPORTATION

UNITED STATES SENATE

ONE HUNDRED EIGHTH CONGRESS

FIRST SESSION

APRIL 2, 2003

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ONE HUNDRED EIGHTH CONGRESS

FIRST SESSION

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FUTURE OF UNIVERSAL SERVICE

WEDNESDAY, APRIL 2, 2003

U.S. SENATE,
SUBCOMMITTEE ON COMMUNICATIONS,
COMMITTEE ON COMMERCE, SCIENCE, AND TRANSPORTATION,
Washington, DC.

The Subcommittee met, pursuant to notice, at 9:35 a.m. in room SR-253, Russell Senate Office Building, Hon. Conrad Burns, Chairman of the Subcommittee, presiding.

OPENING STATEMENT OF HON. CONRAD BURNS, U.S. SENATOR FROM MONTANA

Senator BURNS. We will call the Committee to order. And I must apologize for being a little late. We were at the briefing of the operation now going on in Iraq, and so I overstayed my time there and I beg the patience of members of this Committee and also the witnesses and those who have a high interest in universal service.

I think I am going to forego my opening statement, in the interest of time, and submit it for the record.

Mine is sort of a lengthy statement. But I think it's pretty well understood where we are coming from on this issue. This is an issue that needs to be addressed right now, and there is urgency to it, and working with other members of the Committee and working, of course, with the FCC, we can come up with maybe a solution to this, but we have to work together to do it.

It is a matter of urgency. We know that there have been some abuses. We know that the stream flow into the universal services is down and action is necessary if we are to help out our high-cost areas and ensure telecommunications for everybody in the United States.

So I am going to put my statement in the record, and I thank you for coming today.

[The prepared statement of Senator Burns follows:]

PREPARED STATEMENT OF HON. CONRAD BURNS, U.S. SENATOR FROM MONTANA

Today's hearing concerns a topic which poses an imminent threat to the economic future of rural America: the current looming crisis in universal service. I have always been a strong supporter of universal service during my time in the Senate. Clearly, a solvent and stable Universal Service Fund benefits rural consumers throughout America by providing the backbone for commercial and educational development.

It is because of the critical nature of universal service that I have become alarmed that it has become seriously endangered. A hard look at the numbers reveals the dire nature of the current situation. The size of the Universal Service Fund has exploded upward from just over \$1 billion in 1996 to \$5.7 billion in 2002. Universal service support for 2003 is estimated to be \$6.3 billion, a number that will continue

to spiral upward to over \$7 billion in fiscal year 2004. Such a huge increase in the Fund presents the Congress with a stark fiscal reality that cannot be ignored.

Adding to the difficulty of ensuring a sound Universal Service Fund is the steady decrease in interstate revenues, the primary revenue source from which the Fund draws. Beginning in 2000, interstate revenue began to plateau at roughly \$20 billion per quarter. Unfortunately, from 2000 to today, these revenues have plummeted, to the point where estimated interstate revenues for the first quarter of 2003 are projected at only \$17 billion. The FCC has dealt with this decline by simply increasing the contribution rate assessed on providers of interstate telecommunications services from roughly 5.7 percent in the fourth quarter of 2000 to 7.3 percent in the second quarter of 2002. Just yesterday, the contribution rate was raised again to 9.1 percent. Ultimately, consumers bear this ever-increasing burden and this trend cannot be allowed to continue.

Beyond the way that universal service is being supported, I have also become very concerned at the way that Universal Service Funds are being distributed. While the Schools and Libraries Fund, for example, was designed to support high-cost rural areas in particular, the numbers tell a different story. Since the inception of the schools and libraries program, California has enjoyed a bonanza of nearly \$1.5 billion while Montana has received barely \$18 million. Something is wrong with this picture. Clearly, some significant reforms to the universal service contribution and distribution system need to be made.

I will be carefully reviewing the Commission's work to ensure that it adheres to its stated core principles, which include:

- To ensure the stability and sustainability of the Universal Service Fund.
- To ensure that contributors are assessed in an equitable and nondiscriminatory manner.
- To develop a contribution recovery process that is fair and readily understood by consumers.

My thinking on universal service has been greatly informed by the experience that Montanans have had with their small, rural operators. The achievements of Montana's small independent and cooperative telephone companies are indeed remarkable. Montana's co-ops have now rolled out DSL services to over 170 communities across the state with populations under 3,000. Examples include what the cooperative would consider metropolitan areas such as Glasgow (population 3,572) and Absarokee (population 1,067), but also truly rural communities such as Opheim (population 145), Guildford (population 250) and Loma (population 80). Montana's telephone cooperatives have also deployed more than 100 video conferencing studios across the states, primarily in K-12 schools and Montana's university system, using both ATM and dedicated technology to provide state-of-the-art image and sound quality as well as high-speed Internet access to the schools.

With these and many other contributions of our rural providers in mind, I will be examining ongoing actions at the FCC to make sure that they are consistent with the Act's requirement that universal service support be "specific, predictable, and sufficient." Clearly, difficult decisions must be made as we move forward to ensure the very survival of universal service. We cannot ignore this harsh reality, though, as it is clear that the status quo is unacceptable. I look forward to the testimony of the witnesses. Thank you.

Senator Hollings.

**STATEMENT OF HON. ERNEST F. HOLLINGS,
U.S. SENATOR FROM SOUTH CAROLINA**

Senator HOLLINGS. Well, thank you, Mr. Chairman. It is an extremely important hearing, and I am glad for your comments about the urgency of it. Because we love this dance around the fire of being concerned and doing nothing. Let us find out what needs to be done to maintain universal service.

Right to the point, it is now in terrible diminished condition, threatened. Number one, the long-distance calls that supported it and everything else like that are far less in the sense of e-mail and mobile telephones and everything else of that kind. The other

threat, of course, is that 40 percent cushion is gone due to the good competition that has come about in long-distance service.

Otherwise, we have to get on to some kind of solution. I have been toying a little bit with this. I understand that the best consideration on the table at the moment is perhaps to supplant the universal service charge on long distance with a dollar per connection, but I understand the country boys that you represent, they resist any kind of charge at all. This universal service is for the country boys, and they will be paying far less, but it will be a really reliable source because there are really a plethora of connections, of course, within the city system. And if the distinguished Chairman has a better solution, fine.

Let me, although I cannot stay, welcome our distinguished member, Ms. Abernathy, here, of the Federal Communications Commission, and, in same breath, express my amazement at the arrogance of the Commission trying to legislate telecommunications as information. That is just outrageous nonsense, trying to avoid the responsibility, trying to avoid the requirement of the regulation itself, trying to avoid the administration of the law, which is clear-cut, to come along now and say that broadband communications is all of a sudden just information. You can apply that to all communications and just abandon and dissolve the FCC and all the law itself.

So I just think the message ought to get back to that crowd that keeps trying to ignore the law and trying to find everywhere for market forces. Market forces are the reason that we have a Federal Communications Commission. We interfered with the market and instituted the Federal Communications Commission for the public good.

Let me stop right there and file my statement, and I thank you, again, very much.

[The prepared statement of Senator Hollings follows:]

PREPARED STATEMENT OF ERNEST F. HOLLINGS,
U.S. SENATOR FROM SOUTH CAROLINA

Thank you, Chairman Burns. Today's hearing returns our attention to one of the cornerstones of U.S. telecommunications policy—namely, our commitment to ensuring that *all* Americans have access to quality communications services at reasonably comparable prices. Over the years, our fidelity to this principle of ensuring “universal service” has served our Nation well and has been instrumental to the economic and social well-being of numerous communities across America.

In the early days of telephone service, AT&T, as the monopoly service provider for most Americans, supported universal service internally by setting high rates for long distance services in order to subsidize below-cost rates for local service. For many years, this cross-subsidization worked well to drive the penetration of telephone service into rural America. In 1934, only 40 percent of U.S. households had access to phone service, but by 1980, the number had risen to 94 percent.

Yet, in 1984, when Judge Harold Greene broke up AT&T, these internal support mechanisms were no longer tenable and our system of universal service was forced to adapt to the realities of a competitive telecommunications market. To assist in this regard, Congress enacted the Telecommunications Act of 1996, which articulated twin goals of preserving universal service and promoting competition in the market for local communications services. At that time, Congress made clear that it viewed universal service as “an evolving level of telecommunications services” and tasked the FCC with adopting “specific, predictable and sufficient” mechanisms to support and advance universal service.

Unfortunately, over the past year, the long-term viability of our current mechanism for supporting universal service has come into question. Recent increases in the size of the Universal Service Fund and the shrinking base of interstate revenues have resulted in calls for major modifications to the current contribution mecha-

nism. In addition, growing local competition and the advent of new technologies such as Internet telephony threaten to place added pressures on our current system of supporting ubiquitous, nationwide access to communications services. And while proposals to change the current contribution methodology have been under review by the FCC since May 2001, the FCC has yet to adopt significant changes that would ensure the long-term stability of the Universal Service Fund.

In addition, I remain deeply troubled by the FCC's tentative decision to define wireline broadband services as "information services." Because the statute defines universal service as an evolving level of "telecommunications services," such reclassification would not only ignore Congress' clear intent to allow potential support for broadband through universal service, but more importantly, would risk abandoning rural consumers in their efforts to reap the benefits of advanced services.

As a result, today's hearing comes at a critical juncture, not only for efforts to reform the current means of collecting support, but also for the future of our country in achieving ubiquitous access for all Americans to networks with advanced capabilities. As the FCC addresses these new challenges, it is my hope that they will keep in mind Congress' underlying goal of ensuring reasonably comparable services at reasonably comparable prices.

With this as our guide, I look forward to the testimony of the witnesses and to their responses to our questions.

Senator BURNS. Senator, there is nothing wrong in the country except the city.

Senator HOLLINGS. Yes.

[Laughter.]

Senator HOLLINGS. But they keep on moving to the city.

Senator BURNS. I know it. We have got to stem that flow some way or other. We need to find out a way to make a living out there.

[Laughter.]

Senator BURNS. Well, usually——

Senator HOLLINGS. They sent you in here.

[Laughter.]

Senator BURNS. Yes, I know it. Caught them at a low ebb, though.

[Laughter.]

Senator BURNS. Senator Smith?

**STATEMENT OF HON. GORDON SMITH,
U.S. SENATOR FROM OREGON**

Senator SMITH. Thank you, Mr. Chairman, for holding this important hearing.

I was not here when the 1996 act was passed, but I remain concerned about the FCC's high-cost fund and how it is affecting rural America. For example, under one of its current FCC rural programs, Oregon, my State, receives no support simply because of the way the FCC classifies certain telephone companies as rural carriers and non-rural carriers. Under this rule, the non-carrier that serves rural Oregon is not considered a rural carrier simply because it serves, in addition, parts of an urban area, like Portland, Oregon. And they are concerned that it has the ability to cross-subsidize to support a rural town, like La Grande, Oregon.

These rural customers should be able to take advantage of the Universal Service Funding, and I hope the FCC will take the necessary steps to reform universal service and to distribute funds more equitably across the Nation.

Thank you, Mr. Chairman.

Senator BURNS. Well, thank you, Senator. And I would just point out, in my statement this morning I said I think we have some

abuses out there. And one of them is that I am just noticing here that since the Schools and Libraries Fund has gone in as a result of the 1996 Act, California has collected \$1.5 billion. Montana has collected \$18 million. And it was supposed to be for rural States. Now, I realize California has some rural areas to it, but it doesn't have that many. So we have got to take a look at that, too.

Senator Brownback?

**STATEMENT OF HON. SAM BROWNBACK,
U.S. SENATOR FROM KANSAS**

Senator BROWNBACK. Thank you, Mr. Chairman, for holding the hearing.

Senator BURNS. From a rural State.

Senator BROWNBACK. From a rural State and the country boys. [Laughter.]

Senator BROWNBACK. I identify with you.

Let me say this is incredibly important for us to be able to maintain and ensure that all Kansans have comparable access to basic telecommunications service. I think that is basic, and everybody understands that. The question is where we are going to get the funds, or can we take some places that the funds are currently being dissipated to and get them back to their original purposes, I think is what the Chairman is just citing, that the funds and the amounts going to California versus a State like Montana, because this is meant to be able to make sure that the entire country, regardless of population density, is able to access basic telephone. That is what the Fund is about. And we may, I think, Mr. Chairman, have to look at where all the Fund is going to and see if we can consolidate some of that to get it back more pointed in the right direction and at the primary purpose for which the Universal Fund exists. And that has been my big concern.

I am sorry that Senator Hollings is not here. I would want to say that, to the Commission on the decision regarding broadband information, I think you were perfectly within your right of doing that, and I applaud what the Commission did in that area. This is an area that we have been wrestling around with for some time up here. It has been holding back the expansion of broadband, which clearly we needed to get out, and we needed to get it out in rural areas and less economically attractive areas. And I think the Commission's ruling is really going to help us be able to do that. And so I hope you will take that message back with equal fervor, even if I cannot express it quite as well or as fervently as Senator Hollings can express that. We have been dueling on this topic for some period of time.

Thanks for holding the hearing, Mr. Chairman.

Senator BURNS. Thank you, Senator. And at the danger, at the peril, of being trite, I think once you start looking at universal service, follow the money and we will probably see where some of our problems really lie in this Fund.

Commissioner Abernathy, thank you for coming this morning, and we look forward to your testimony. You will probably be the target of a few questions from this panel. So thank you for coming this morning.

**STATEMENT OF HON. KATHLEEN Q. ABERNATHY,
COMMISSIONER, FEDERAL COMMUNICATIONS COMMISSION**

Commissioner ABERNATHY. Thank you very much, Chairman Burns and Senator Brownback, Senator Smith. And it is a privilege to be here, and I appreciate the opportunity to appear before you to discuss the FCC's efforts to preserve and advance universal service and to listen and learn from you about your priorities and ways that we can improve the mechanism.

The goal of providing high-quality telecommunications services to all Americans at affordable rates is a cherished principle in U.S. telecommunications policies and one of the cornerstones of the Telecommunications Act of 1996. From Alaska to Alabama, from Montana to Mississippi, Universal Service Funding has guaranteed citizens the ability to communicate at reasonable rates across the country.

I know that every member of this Subcommittee understands the importance of universal service, and as chair of the Federal-State Board on Universal Service, I also make it a top priority for me. Indeed, during my confirmation hearing, I pledged to protect universal service, and I reaffirm that pledge today.

Shortly after Congress enacted Section 254 of the Act, the FCC then adopted rules regarding the collection and the distribution of universal service support. And now, with several years of experience under our belts, we are engaged in a reexamination of many aspects of the program to ensure that each component is administered as fairly, efficiently, and effectively as possible. As we engage in this review, the FCC's commitment to preserving and advancing universal service remains unwavering.

My written statement provides significant details on the various challenges that are confronting the Universal Service program and they are outlined in each of our pending rulemaking proceedings. So I thought what I would do this morning is touch on a representative sample of the issues that we currently have under review.

I will begin with the high-cost support mechanisms which are at the core of our efforts to preserve and advance universal service. The FCC must ensure that support for companies serving high-cost rural areas is distributed in a rational and an even-handed manner and that growth in the demand for funding does not overwhelm the ability to pay for this support.

We have three proceedings underway that are designed to further these objectives. In one of these proceedings, we are focusing on how to appropriately support new competitors serving high-cost rural areas. This proceeding is important to our efforts to harmonize two statutory directives that sometimes appear to be in tension. The first is promoting competition, and the second is preserving universal service.

The FCC recently referred this proceeding to the Federal-State Joint Board for an analysis of the Commission's rules that govern how competitive carriers receive high-cost support. While new competitors, including wireless providers, currently receive less than 2 percent of the total Universal Service Funding, this share is growing rapidly. And when you combine that trend with the fact that incumbent carriers do not lose any support if a customer switches to a new competitor service, it becomes apparent that rule changes

may be necessary to avoid placing unreasonable strains on the high-cost support mechanism.

The Joint Board's task is to review the rules under which the States designate competitors as eligible telecommunications carriers or ETCs, because, once designated, the carrier then qualifies for Universal Service Funding. The Joint Board will also be looking at the manner in which competitive ETCs receive support. I have long questioned whether supporting competitive ETCs based on the incumbent carrier's network costs and not their own costs is the right approach. So the Joint Board will carefully examine that issue. And last, the Joint Board will consider the implications of continuing to provide support for multiple lines per household.

Another issue requiring the FCC's attention is the universal service mechanism that provides support for schools and libraries, rural healthcare facilities and low-income consumers. The challenge in these proceedings is to remove unnecessary impediments to the flow of appropriate support while continuing to ensure that adequate safeguards are in place to prevent waste, fraud, and abuse.

For each program, I am confident that we can build upon the lessons learned over the initial years of operation and find ways to cut red tape and make it less burdensome for program beneficiaries to obtain support where appropriate. For example, in the E-rate program, the Commission likely can simplify the appeals process for small schools and rural healthcare program. And we are considering a number of proposed changes to enable clinics to overcome obstacles. But make no mistake; we are also reviewing our rules with an eye toward ensuring that our funds are disbursed in an efficient, fair, and carefully supervised manner. And while the Commission and USAC have always been concerned about combating waste, fraud, and abuse, we now know that some entities have apparently sought to manipulate our rules to the detriment of other qualifying applicants, and we need to make sure that we correct these problems.

And a final set of challenges relate to the methodology for assessing universal service contribution on carriers. As pointed out by Senator Collins, we must ensure that sufficient funds continue to flow into the system and that the funding burden is spread among contributors in an equitable and nondiscriminatory manner. We took some steps last December to stabilize the universal service contribution factor in order to mitigate the growing funding burden, but more fundamental reforms may be necessary to ultimately protect universal service over the long haul. And that is why we are looking at a collection mechanism that may be based primarily on end-user connections, as well as several other options, in order to ensure the long-term viability of the Fund.

So, in conclusion, universal service is facing a number of challenges, but I am confident that, with your help and guidance, the FCC will be able to ensure the sustainability of the various support mechanisms and continue to deliver telecom services to consumers at just, reasonable, and affordable rates. We have a number of proceedings that have been initiated, and together I believe we can respond to the challenges that lie ahead.

Thank you very much.

[The prepared statement of Ms. Abernathy follows:]

PREPARED STATEMENT OF HON. KATHLEEN Q. ABERNATHY, COMMISSIONER,
FEDERAL COMMUNICATIONS COMMISSION

Good morning, Chairman Burns, Senator Hollings, and distinguished members of the Subcommittee. I appreciate the opportunity to appear before you to discuss the FCC's efforts to preserve and advance universal service.

The goal of providing high-quality telecommunications services to all Americans at affordable rates is a cherished principle in U.S. telecommunications policy and one of the cornerstones of the Telecommunications Act of 1996. I know that every member of this Subcommittee understands the importance of universal service, and, as Chair of the Federal-State Board on Universal Service, I make it a top priority to ensure that the Federal support mechanisms fulfill their objectives.

The 1996 Act directed the FCC to promote two key goals that at times appear to be in tension with one another: opening local markets to competition and preserving universal service. The prior monopoly environment enabled regulators to promote universal service by building implicit subsidies into local and long distance rate structures. The introduction of competition, however, erodes these subsidies as new entrants undercut rates that were set well above cost, such as business rates in urban areas. Congress accordingly directed the FCC to adopt explicit support mechanisms that would be sufficient to ensure that rates remain affordable and reasonably comparable throughout the Nation. In response, the FCC developed several explicit support mechanisms for carriers that provide service in high-cost areas. High-cost support will total over \$3.2 billion in 2003.

Congress also expanded the scope of universal service by directing the Commission to establish support mechanisms for schools and libraries and for rural health care facilities. The schools and libraries program (often called the e-rate program) provides up to \$2.25 billion in annual support and has enabled millions of school children and library patrons to gain access to advanced telecommunications and Internet services. While the rural health program generally has been underutilized, the FCC is considering a variety of measures to strengthen it, as discussed below.

In addition to the high-cost support mechanisms and the programs supporting schools, libraries, and rural health clinics, the FCC's Lifeline and LinkUp programs provide discounts off monthly service charges and connection fees to ensure that low-income consumers have access to basic telephone service. Last year, these programs provided approximately \$647 million in support.

All of these programs promote the universal service goals set forth in section 254(b) of the Act, including the availability of quality services at affordable rates; access to advanced services in all regions of the Nation; comparable access to telecommunications services for all consumers, including low-income consumers and those living in rural, insular, and other high-cost areas; and access to advanced services for schools, libraries, and rural health care facilities. Shortly after Congress's enactment of the 1996 Act, the FCC adopted rules regarding the collection and distribution of universal service support. Now, with several years of experience under our belts, we are engaged in a reexamination of many aspects of the program to ensure that each component is administered as efficiently and effectively as possible. A host of marketplace and technological developments have already prompted some course corrections, and may ultimately cause us to reassess certain fundamental policy choices made in the initial implementation period. As we engage in this review, our commitment to preserving and advancing universal service remains unwavering.

I describe below some of the challenges confronting universal service and the efforts the FCC has underway to ensure that each component of the universal service program remains faithful to the principles set forth in section 254 of the Act. These proceedings aim to improve and strengthen all of our support mechanisms, and therefore will benefit consumers in high-cost areas, families with low income, and patrons of schools, libraries, and rural health care facilities.

High-Cost Support

The Commission and the Joint Board have three pending proceedings that focus on the distribution of support to high-cost areas. First, with respect to the support mechanism for non-rural carriers (the Bell operating companies and other large independent LECs), the FCC is considering a Recommended Decision from the Federal-State Joint Board in response to a remand by the Tenth Circuit Court of Appeals. The court ruled that the Commission did not adequately explain how the non-rural support mechanism is sufficient to enable states to set affordable rates that are reasonably comparable in both rural and urban areas. In particular, the court

directed the Commission to consider how to induce states to develop their own support mechanisms to fund high-cost areas within their borders, since the Federal mechanism aims primarily to mitigate cost differentials *among* the states. The Joint Board issued its recommendations last October, and the Commission will complete its consideration of the issues later this year.

A second FCC proceeding relating to high-cost support focuses on the definition of services that are eligible for universal service support. Supported services include voice-grade local service, access to 911, access to interexchange services, and other basic local services. In a Recommended Decision issued last July, the Joint Board recommended maintaining the existing list of supported services. One issue that is likely to be of interest to the Subcommittee was the Joint Board's discussion of providing direct support for broadband services, in addition to the support for underlying loop facilities that carriers receive today. The Joint Board recognized the increasing importance of broadband services in the lives of American consumers, but concluded that broadband fails to satisfy most of the eligibility criteria set forth in section 254(c)(1) of the Act. Specifically, the Joint Board stated that broadband services are not yet *essential* to education, public health, or public safety, because such resources are readily accessible through alternative means, such as voice service or dial-up Internet service. In addition, broadband services have not been subscribed to by a substantial majority of residential customers. The Joint Board further opined that providing direct support for broadband services—in addition to already providing support for underlying loop facilities—would not serve the public interest, because it would place enormous financial burdens on American consumers and threaten the sustainability of the Universal Service Fund. Moreover, because ETCs must provide all supported services to be eligible for funding, adding broadband to the list would threaten to withdraw support from those carriers that have not yet upgraded their networks to enable the provision of broadband services. The Commission is currently considering this Recommended Decision and will issue a final order later this year.

The third proceeding regarding high-cost support will focus on the intersection of competition and universal service in rural areas. The Commission referred this proceeding to the Joint Board in November 2002, and the Joint Board issued a public notice seeking comment in February. The issues for comment include the impact of providing support to competitive eligible telecommunications carriers (ETCs) on the growth of the Universal Service Fund, the manner in which competitive ETCs receive support (often called “portability”), and the consequences of supporting multiple lines per household. The public notice also sought comment on the process for designating ETCs and whether the FCC should establish guidelines for consideration by the state commissions that make these determinations under section 214(e)(2). Following the close of the comment period, the Joint Board intends to organize a public forum involving rural LECs, wireless carriers, consumer groups, and other interested parties to gather additional information.

While this rulemaking is only in its preliminary stages, its importance is undeniable and it will accordingly be the Joint Board's primary focal point in 2003. Of the 1,400-plus ETCs that received high-cost support in the fourth quarter of 2002, 63 were competitive ETCs (including a number of mobile wireless carriers). Competitive ETCs received approximately \$14 million that quarter, compared to more than \$800 million for incumbent LECs. Yet this support flowing to competitive ETCs was seven times higher than in the first quarter of 2001. So while the share of high-cost support distributed to competitive carriers remains small (less than 2 percent of the total), it is growing quite rapidly. This trend underscores the timeliness of the Commission's review of its rules for providing support to competitive ETCs.

Schools and Libraries and Rural Health Care Facilities

Now that the Commission has had significant experience overseeing the support mechanisms for schools and libraries and rural health care facilities, we are seeking in two pending rulemakings to capitalize on this experience by making these programs more effective and efficient.

The schools and libraries proceeding aims to streamline the application and appeals processes by eliminating red tape and any other needlessly burdensome requirements. At the same time, this rulemaking focuses on potential rule changes to address issues that have been identified in the course of the Commission's ongoing oversight of the e-rate program. The Commission is fully committed to taking actions where necessary to address waste, fraud, and abuse and will consider initial rule changes based on the record in the very near future. I have also announced that, in cooperation with Chairman Powell and my other colleagues, I am organizing a public forum on May 8 focusing on several of the oversight issues raised in the rulemaking. To the extent that issues remain outstanding following the Commis-

sion's upcoming Report and Order, I hope that the public forum will enable us to quickly develop a consensus on additional means of protecting against gaming of the system. Our efforts to improve the Commission's oversight will help ensure that funds are disbursed in an efficient and evenhanded manner so that deserving school children and library patrons continue to have access to critical services.

The Commission's rulemaking on the support mechanism for rural health care facilities likewise seeks to strengthen the program. Whereas the schools and libraries program cannot fully fund applicants' requests, the rural health program has been underutilized. The notice of proposed rulemaking sought comment on ways to modify eligibility requirements to eliminate obstacles to rural health clinics' receiving support while remaining faithful to the statutory purposes. The Commission recognizes that facilitating telemedicine by connecting rural health clinics to regional hospitals and universities takes on added importance in light of the increased threat of terrorism. We accordingly hope to complete this proceeding expeditiously.

Low-Income Support

The third component of the Federal universal service regime is the low-income support mechanism, Lifeline/LinkUp. The Joint Board will soon release a Recommended Decision on proposals to bolster the effectiveness of this mechanism. This Recommended Decision suggests new ways for low-income consumers to qualify for support and also addresses questions regarding states' efforts to engage in outreach and to verify program eligibility. As with the e-rate and rural health care programs, the goal of the rulemaking is to remove impediments to beneficiaries' receiving support while simultaneously preserving the integrity and enhancing the efficiency of the program.

Contribution Methodology

Each of the programs described above draws support from a pool of carrier contributions made pursuant to section 254(d). In a series of related proceedings, the Commission has been actively exploring changes to the methodology for assessing contributions on carriers. Since 1997, contributions to the explicit support mechanisms have been assessed on carriers as a percentage of their revenues from end-user *interstate* telecommunications services. Several trends have combined to put upward pressure on the contribution factor (which is currently 9.1 percent), which in turn has increased the funding burden on consumers. While long distance revenues grew between 1984 and 1997, they have since been flat or in decline as a result of price competition and substitution of wireless services and e-mail. Because Federal universal service contributions by law may be assessed only on interstate revenues, this shrinking of the revenue base has caused the contribution factor to rise steadily. Another important trend has been the increasing prevalence of bundled service plans. For years, wireless carriers have offered buckets of any-distance minutes at flat rates, and now wireline carriers such as MCI and Verizon are offering packages including local and long distance for a single price. In addition, many carriers offer business customers bundles that include local and long distance voice services, Internet access, and customer premises equipment. Such bundling has been a boon for consumers but has made it difficult to isolate revenues from interstate telecommunications services. And the problem is likely to get worse as bundling becomes more and more popular.

In December 2002, the Commission adopted a number of measures to stabilize the universal service contribution factor in an effort to mitigate the growing funding burden on consumers. For example, the Commission increased from 15 percent to 28.5 percent the safe harbor that wireless carriers may use to determine the interstate percentage of their revenues. The Commission also eliminated the lag between the reporting of revenues and the recovery of contribution costs, which lessened the competitive disadvantages facing long distance carriers with sharply declining revenues. And the Commission prohibited mark-ups of contribution costs on customers' bills to ensure that carriers cannot profit from inflated line charges.

While these were important steps, more fundamental reform may be necessary to ensure the sustainability of Universal Service Funding in the long term. Bundling together interstate and intrastate services—and telecommunications and information services—gives carriers the opportunity and incentive to understate the portion of their revenues that are subject to assessment and increases the difficulty of identifying interstate revenues. Contribution factors therefore are likely to continue their ascent under a pure revenue-based contribution methodology.

For this reason, the Commission is continuing to consider whether a contribution methodology incorporating a component based on end-user connections, in addition to or in lieu of our revenue-based methodology, may create a more sustainable model for funding universal service in the future. The number of end-user connec-

tions has been more stable than the pool of interstate revenues, and connection-based charges can be adjusted based on the capacity of each connection to ensure an equitable distribution of the funding burden among business and residential customers. The Commission has sought comment on several proposals and will consider additional changes to the contribution methodology based on the record now being developed. The Commission also has sought comment, in the Wireline Broadband NPRM, regarding the possibility of assessing contribution obligations on facilities-based providers of broadband Internet access services. We will seek to ensure that any modifications to the contribution methodology that are designed to promote sustainability will also remain faithful to the statutory requirement that contributions be assessed in an equitable and nondiscriminatory manner.

Taken together, the reforms being considered by the Commission should ensure the continued vitality of the Federal universal service support mechanisms. The Commission has no higher priority than delivering on the promise of ubiquitous, high-quality, and affordable services. I would like to thank you, Mr. Chairman, for calling this hearing, and I look forward to working with you and other members of the Subcommittee on these challenging and critical issues.

Senator BURNS. I thank you, Commissioner.

And I would say that part of the criticism that was expressed by Senator Hollings does have basis. And I would say, you know, that the law is clear that requires the Commission to create a specific and predictable support mechanism for universal service.

We have known for some time now that we are going to have to act on universal service, and we have seen no action taken by the Commission. And in fact, they have looked at I do not know how many approaches down there, but none of them have been acted on or recommended to Congress if legislation is required. The Commission has already issued over 50 orders in this docket. There are still numerous issues awaiting resolution.

Is a comprehensive solution possible to this admittedly difficult and complex problem? And should we expect constant tinkering around with the support of the mechanism? In other words, let us get something definitive out of the Commission, some recommendations, and let us start dealing with it because if we do not, we are going to find ourselves in a bigger pickle than we are already in.

Commissioner ABERNATHY. I agree with you, Senator. And I think one of the reasons why before the end of the year I would hope we will have an item out on changes to the contribution methodology. The current way that we collect funding is under tremendous stress, and it is not clear that over the long-term it is sustainable and that it will continue to be able to support the programs and be collected in a reasonable way across all the carriers.

So we are looking at a number of alternatives, including a connection-based approach, where essentially you look at what are the connections that each carrier has with customers, and you assess in that manner. This helps us with the problem that it is now difficult to isolate out interstate revenues. We have a lot of carriers that offer bundled services, and it is very difficult as a regulator to identify which part of that revenue stream is interstate and, therefore, appropriately contributing toward the Universal Service Fund.

And I think it is also appropriate for us to spread the Fund across as many telecom services as possible, because then the burden on any one group is lessened. Once we make this decision, I have no doubt that it will be appealed, and we will find out if the court is comfortable with the way that we have interpreted our statutory authority. And if a court tells us that we cannot get more

creative, if a court tells us that we cannot collect in a way that we think is necessary for long-term stability, then we may very well be back in front of you asking for some help.

Senator BURNS. Well, it looks like we are almost to that point now. In other words, if we think we are going to get appealed on any decision that we might make down there, it would seem to me that it is time that a dialog is struck between Congress and the FCC to sit down at some kind of a summit and to get the ideas of what we think we can do up here and what has got to be done up here and what your limits are at the FCC. In other words, let us not let this just drag out to the point where nobody makes a decision.

Commissioner ABERNATHY. OK.

Senator BURNS. I think we are at that point now. Despite the constant revisions and all of this, I still think that a number of carriers have advocated moving to a system with larger base revenues. There is no doubt about that. And if we are going to stabilize in the long run, then let us identify those areas and let us deal with it here with some sort of coordinated thought between what the desires of Congress are and the challenges you have.

In other words, let us work together on this thing. Let us not get out there and just make a bunch of lawyers rich. Let us deal with it here. Of course, I guess it does not make any difference to the lawyers downtown or up here. It does not make any difference. Somebody is going to get paid for their work. And, you know, they ought to have some sort of a—have they got a minimum wage for those folks?

[Laughter.]

Commissioner ABERNATHY. I think so.

Senator BURNS. But anyway, what I am trying to do is to force us and also force you into a dialog. Let us identify, let us see what has to be done. Let us take a look at the testimony and the things that you have done. Let us study a little history. But I think it is mandatory, it is vital, that we solve this thing this year. I just do not want to just keep drifting out there and see nothing happen.

Do you want to comment on that?

Commissioner ABERNATHY. Yes. I think it is a great idea.

Senator BURNS. I have lost my supporting cast here.

Commissioner ABERNATHY. I know, but you are who matters.

I think it is a great idea, and certainly what we can do through the Joint Board is to get together with you and the members of your staff and the Subcommittee and walk through each of the proceedings that we have pending, walk through some of the challenges that we are facing, the ones we think we can address consistent with the statute that exists today, the ones that we think are more difficult because of some court orders and some statutory language, and see what we can do to work together, because I—I have said this, and I think my fellow commissioners have said this—if we do not make changes, we will have problems.

The good news is that today, you know, it is still working. We are still collecting the funding. We are still distributing it across the country. We are still ensuring that rates are affordable and reasonably comparable across the country. But the pressures are significant, as you have noted, and if we do not get ahead of this

problem and correct it before it is too late, then we will have serious problems in rural America, and that is not something that any of us wants to see.

So I am happy to work together with you and the Subcommittee and your staff to, sort of, walk through all the various proceedings and identify where we might be able to better work together.

Senator BURNS. Well, I just get the notion that the light at the end of the tunnel may be a slow-moving freight coming our way. [Laughter.]

Senator BURNS. And that is what, sort of, excites me about this whole thing. I thank you for your testimony this morning. I want to get on to my panels. I always like for the fight to break out at that table rather than up here. But I think there are other questions coming from other members of this committee, so if you could respond in writing, I would sure—

Commissioner ABERNATHY. Absolutely. I am happy to respond to any questions.

Senator BURNS. I can surely appreciate that. And thank you for coming this morning.

Commissioner ABERNATHY. Thank you, Chairman Burns.

Senator BURNS. We can go to our second panel, which is Joel Lubin, Vice President, Federal Government Affairs for AT&T; Robert Orent, President and CEO of Hiawatha Communications out of Munising, Michigan; Matthew Dosch, Vice President, External Affairs for Comporium Communications, Rock Hill, South Carolina; Carson Hughes, Chief Executive Officer of Telepax, from Jackson, Mississippi; and Bill Gillis, Director of Center to Bridge the Digital Divide, Washington State University, from Pullman, Washington, old Wazoo. What makes me sort of familiar with that, I had a daughter that went to UW, so I know all about those.

With that, we will just go kind of in order. Mr. Lubin, who is Vice President of AT&T Corporation from here in Washington, and we welcome you here this morning and look forward to your testimony.

**STATEMENT OF JOEL LUBIN, VICE PRESIDENT,
FEDERAL GOVERNMENT AFFAIRS, AT&T CORPORATION**

Mr. LUBIN. Thank you, Mr. Chairman.

Senator BURNS. You might pull that microphone up, because there are some folks that, in the back, are keeping notes, and I do not want them to get the wrong note.

Mr. LUBIN. All right. Thank you, Mr. Chairman.

I appreciate having the opportunity to speak before this Subcommittee today on this very critical subject of universal service, on behalf of AT&T. AT&T strongly supports the 1996 Telecommunications Act's twin goals of promoting competition and preserving and advancing universal service.

Let me go right to the bottom line. The current universal service system is broken. The reason it is broken is because the current size of the Fund of \$6.1 billion, and growing every quarter, is being collected on an interstate revenue and international revenue base that, unfortunately, is declining. For the last 2 years, it has declined 8 percent a year.

Chart A of my written submission shows what the assessment rate will be in the end of 3 years given different assumptions about growth rates of the Fund and the interstate retail revenues. It is not a pretty picture. If you look at that chart, you will see that the assessment rate could rise to 12, 13, 14, 15 percent based on what you believe the growth of the Fund is and how rapidly interstate retail revenues are going to decline. That is the bad news. The good news is, my belief is, that that can be solved under the existing structure of the telecommunications law.

AT&T has put forward a solution that you contribute based on telephone numbers, working telephone numbers for the end user, and, to the degree there is not a working telephone number, then you assess the special access line or private line going to the public network.

Chart B of my submission shows what illustratively that could do. For approximately one dollar you can generate significant amounts of funds which would stabilize the overall USF fund. That is item one.

Item two that I would like to highlight to you is the concern that AT&T sees access charges in terms of rural areas of the country versus the large regional Bell Operating Companies. The good news here is, in the last few years, interstate access prices have been reduced to approximately 6 cents per minute per end for Regional Bell Operating Companies. Unfortunately, the price of access in independent telephone company territories also has been reduced, but it is still approximately 2.6 cents per minute on average, and it could be as high as 10 cents a minute.

The dilemma is that Section 254(g) of the law states prices in rural areas should be comparable to prices in the urban areas. That requires nationwide average toll pricing. Unfortunately, there is more and more pressure on long-distance prices to not be average prices simply because post-271, when Regional Bell Operating Companies entered the marketplace, they began serving their own geography, and, as I mentioned, they are charging access for about 6 cents a minute. In rural areas, however, people are being charged two-and-a-half cents, 2.6 cents, which is approximately five times greater than what they are being charged in the large-company territories, and that is a dilemma.

Again, the Regional Bell Operating Companies have said, and some of them have publicly stated, that they are only going to serve long-distance where they have local. So they are competing on their areas where access is about .6, and AT&T is competing in those areas, but AT&T is also competing in the areas of rural America.

We put forth a solution to that problem, as well. If you look at the difference between what access is in the rural areas and what access is in the urban areas, we are suggesting lowering the rate in the rural areas to a target of approximately 95 cents and putting the difference in a Universal Service Fund. Submission C-1 and C-2, attachments C-1 and C-2, are showing the problem that exists under the current rates and how that problem could be greatly mitigated under the proposal I just put forward. Unless a proposal, some version of what I have just described, happens, there will be

suboptimal solutions in rural areas that rural customers should not have to bear.

I appreciate the opportunity to be here today. AT&T continues to believe that the Telecommunications Act can meet the twin goals of maintaining universal service and promoting competition.

I look forward to answering your questions. Thank you very much.

[The prepared statement of Mr. Lubin follows:]

PREPARED STATEMENT OF JOEL LUBIN, VICE PRESIDENT,
FEDERAL GOVERNMENT AFFAIRS, AT&T CORPORATION

Mr. Chairman, Senator Hollings, and members of the Subcommittee, good morning. I thank you for inviting me to testify today to share AT&T's views as you address the important topic of universal service.

AT&T strongly supports the 1996 Act's twin objectives of opening markets to competition and preserving and enhancing universal service. We are proud of our history as the Nation's oldest and most far-reaching long distance carrier. We are proud to connect rural and distant parts of America—including states like Montana, Alaska, South Carolina, Hawaii, North Dakota and West Virginia that are represented on this subcommittee—with the rest of the country. More than any other carrier, we tie together all parts of America. On the basis of this experience, we understand the importance of universal service.

The Current Assessment System Is Unsustainable and Should Be Replaced

In 1996, the Congress directed the FCC, with the assistance of a Federal-State Joint Board, to charter a new universal service mechanism—one that would work with, not against, competition in all markets. One that would be specific, predictable, and sustainable as competition grew. One that would not distort competition, either in the way contributions are collected or support is distributed.

The FCC has made significant progress in moving implicit subsidies into an explicit USF, most notably through adoption of the CALLS plan in May 2000 and adoption of the MAG plan in October 2001. Nonetheless, seven years after the 1996 Act, we cannot say we have a universal service system that meets all of the goals set forth by Congress in 1996. Instead, we have an ever-increasing Universal Service Fund that is being raised from an ever-shrinking funding base—interstate and international end user telecommunications revenues. And the mechanisms the FCC has in place for collecting universal service support are discriminatory and self-defeating. Something has to give.

It is beyond question that the Fund is increasing. The Fund today stands at more than \$6 billion per year. Both the Office of Management and Budget and FCC staff project additional increases in the size of the Universal Service Fund, even if the FCC makes no further policy changes that add to the obligations supported through the USF. OMB projects total growth at just under 2 percent per year for FY 2004–2007. Only two parts of the Fund won't grow—the schools and libraries fund and the \$650 million interstate access support for areas served by price-cap carriers. All other parts of the USF can and are likely to increase.

At the same time that the system faces increasing demands for support, the Universal Service Funding base—interstate and international end user telecommunications revenues—continues to shrink. In 2001 and 2002, the Universal Service Funding base shrank by an average of 8 percent per year. Chart A, which is appended at the end of my testimony, shows the results of the 2 percent fund growth predicted by OMB and an 8 percent annual decline in the funding base. In three years, the USF contribution factor—the rate carriers are assessed and that they pass on to consumers at the bottom of the bill—would rise from 9.1 percent today to 12.8 percent in 2006. Such a result is likely to be both economically and politically unsustainable.

The competitive inequities built into the current system for raising USF support will only speed the shrinkage of the USF funding base. These competitive inequities take several forms. For example:

- If a consumer is a high-volume user of long distance service—the customer who traditionally has contributed the most to support universal service—that consumer can pay less into the Fund by migrating his or her long distance calling to a wireless phone.

- If a consumer purchases interstate long distance bundled with local service or information services, he or she can contribute less in universal service if the carrier providing the bundle allocates more revenue to the parts of the bundle that do not contribute to universal service support than to the interstate long distance bill, which supports universal service.
- If a consumer uses service provided by international carriers that carry little or no interstate traffic, he or she can avoid universal service charges altogether on that international calling.
- If a consumer uses Voice over Internet Protocol services, e-mail, or instant messaging, it is likely that consumer would not contribute anything to support universal service.

Each of these outcomes encourages carriers and consumers to seek ways to avoid contributing to the Fund, and increasingly, price sensitive consumers are moving to services that allow them to avoid paying universal service support. As a result, the USF support mechanism appears headed for a "death spiral." Put another way, as the USF contribution base shrinks, the assessment rate goes higher, which causes more customers to figure out ways to minimize their universal service charges, which in turn causes the USF contribution base to shrink further. As Senator Stevens recently noted, something must be done or the system will become unsustainable. Such an outcome would be completely at odds with what the Congress directed in Section 254.

Because AT&T is deeply concerned about this problem, we have proposed a solution to the FCC—a universal service contribution system based on telephone numbers for those services that use telephone numbers, and on connections to the public network for special access and private line services that do not use telephone numbers. Chart B, also at the back of my testimony, shows what would happen under this plan as the Fund grows, and numbers-based and special access connections increase. If numbers/special access connections grow 2 percent per year, a 2 percent annual increase in the Fund will not change at all the \$0.93 per number universal service assessment.

Moreover, a numbers-based solution offers the advantage of being "future-proof." Voice-over-Internet-Protocol (VoIP) providers give their customers a telephone number so that those customers can receive calls from the public switched network. This assignment of numbers will trigger an obligation to support universal service, with the effect of keeping VoIP in the universal service contribution base.

We believe that a numbers-based solution could be implemented today by the FCC under its existing statutory authority. What is needed is the will for reform.

Geographic Toll Rate Averaging: Access Reform Is Necessary to Preserve Competition

As I said at the start, AT&T is proud of its heritage as the carrier that truly ties America together. But today, the burden of tying America together—of providing long distance service in all corners of the country—is being borne substantially by AT&T. AT&T is carrying this burden, even as it must increasingly compete in long distance with RBOCs that provide long distance service only in their largely urban, lower-cost service areas.

As part of the 1996 Act's universal service provisions, Congress—and really the members of this committee—ensured that all Americans could be tied together affordably by mandating rate averaging and rate integration for long distance services.

But interstate access charges—a significant component of the cost of long distance service—are not the same in all parts of the country. The geographic toll rate averaging provisions of Section 254(g) make it imperative that the remaining traffic sensitive cost disparities be removed from interstate access rates and made explicit through the USF.

In most areas served by the RBOCs, this reform was implemented through the CALLS plan, and interstate access charges are now approximately .6 cents per access minute. In the areas served by small, rural carriers not covered by the CALLS plan, the average interstate access charges we face are much higher. For example, the average NECA minute of access averages 2.6 cents per minute. When AT&T averages its toll rates nationwide, it has to charge its customers in the RBOC territory more than it otherwise would, in order to charge the customer in the small, rural carrier's service area the average rate.

This burden was barely bearable before Bell entry into the long distance market, when AT&T had to compete with MCI, Sprint, and other carriers that could choose not to serve certain geographies or service areas. Now, with the Bells having secured 271 approval to enter the long distance market in most of the country, this

burden has become intolerable. Verizon, which is already the third largest long distance carrier in the country gets an unfair competitive advantage from the Act's toll averaging requirements because it doesn't serve all of America. At the back of my testimony, Chart C1 demonstrates this problem.

Fortunately, the 1996 Act allows for a solution that preserves toll averaging while restoring a level playing field to long distance competition. The local network costs—primarily high switching and transport costs—that lead to these high rural company access charges—which can be as high as 10 cents per minute of use—could be supported through explicit universal service support in much the same way as in the CALLS plan adopted by the FCC. Chart C2 illustrates the outcome if this problem is solved in a manner similar to that employed in the CALLS plan.

Two years ago, AT&T and several other carriers presented just such a proposal to the FCC. Unfortunately, the FCC did not implement our proposal, and in the two years since that time, the economic challenges that led us to file our plan have gotten worse. We need relief.

Unless the FCC acts aggressively, the marketplace will force AT&T and other national carriers to find other, less optimal solutions. Those options are not attractive to us, nor should they be attractive to policymakers, and rural America should not be forced to bear their cost.

Wireless Service and Multiple Connections: How Much Support Is Enough?

Providing for a sustainable funding mechanism is just part of the challenge we face. Decisions also must be made regarding just how many network connections universal service will support for each household. The miracle of wireless phones is that they make connections truly personal. But are we really going to pay universal service support for four or five connections for a family of four? Are we ready to foot that bill? If policymakers decide that this type of support is acceptable, they must be prepared for a significant increase in the demands placed on the USF.

By making this point, I am not suggesting that the FCC's implementation of Section 254 should bar wireless carriers from receiving USF support. Any decision about how many lines to support to a household must be competitively neutral in its application. LEC-provided multiple lines to a household are no more sacrosanct than wireless-provided multiple lines. But how many lines to a household constitute universal service?

It is important to decide what it is really necessary to subsidize because no Universal Service Funding mechanism can raise an unlimited amount of USF support. This issue needs additional attention from the FCC and the Federal-State Joint Board.

In addition, attention must be paid to the discriminatory advantage wireless-based long distance services have with respect to universal service contributions. With the wireless "safe harbor" set at 28.5 percent, any wireless carrier whose actual percentage of interstate traffic exceeds 28.5 percent will simply elect the "safe harbor." As such, it operates as an absolute cap on wireless contributions that is not available to wireline long distance carriers. This is highly discriminatory and provides an incentive to shift interstate traffic from wireline service to wireless service.

Assume, for example, that a customer has 200 minutes of interstate long distance usage at 5 cents per minute. If that customer can shift those 200 minutes of usage to a wireless plan, and pay \$10 in additional wireless charges, he or she will rationally do so. Why? Because the effect of the "safe harbor" is to substantially reduce this customer's obligation to pay universal service support. The impact of this incentive is dramatic, and we believe it is flatly at odds with Section 254's direction that universal service contributions be "equitable and non-discriminatory." This inequity should be fixed.

Mr. Chairman, thank you again for the opportunity to testify here today. At AT&T, we believe firmly that competition and universal service can go hand-in-hand. But decisions must be made, and some bold actions taken to secure universal service for the future. On behalf of my company, I hope you agree, and look forward to working with you and the members of this subcommittee as you continue your important work in this area.

Exhibit A

**Assessment Rates at the end of 3 years
Current Revenue Based USF Mechanism**

		Annual % Change in the Assessable USF Revenue Base					
		-8.0%	-6.0%	-4.0%	-2.0%	0.0%	2.0%
Annual % Change in FUSF Program Costs	0%	12.0%	11.2%	10.4%	9.7%	9.1%	8.5%
	2%	12.8%	11.9%	11.1%	10.4%	9.7%	9.1%
	4%	13.7%	12.7%	11.9%	11.1%	10.4%	9.7%
	6%	14.6%	13.6%	12.6%	11.8%	11.0%	10.3%
	8%	15.6%	14.5%	13.5%	12.6%	11.7%	11.0%
	10%	16.6%	15.4%	14.3%	13.4%	12.5%	11.7%

Exhibit B

**Assessment Rates at the end of 3 years
Working Telephone Number & Special Access
Capacity Based Alternative USF Mechanism**

		Annual % Change in Working Telephone Numbers & Special Access Capacities					
		-2.0%	0.0%	2.0%	4.0%	6.0%	8.0%
Annual % Change in FUSF Program Costs	0%	\$ 0.98	\$ 0.93	\$ 0.87	\$ 0.82	\$ 0.78	\$ 0.74
	2%	\$ 1.05	\$ 0.98	\$ 0.93	\$ 0.87	\$ 0.83	\$ 0.78
	4%	\$ 1.11	\$ 1.04	\$ 0.98	\$ 0.93	\$ 0.88	\$ 0.83
	6%	\$ 1.17	\$ 1.10	\$ 1.04	\$ 0.98	\$ 0.93	\$ 0.88
	8%	\$ 1.24	\$ 1.17	\$ 1.10	\$ 1.04	\$ 0.98	\$ 0.93
	10%	\$ 1.31	\$ 1.23	\$ 1.16	\$ 1.10	\$ 1.04	\$ 0.98

Exhibit C1

Effect of High Access Charges on LD Competition – *MAG Order*

Hypothetical Company	Price Cap - Price Cap MOU	Price Cap - NECA MOU	NECA - NECA MOU	Avg Access per Conv. MOU/Minute	% of Nationwide Carrier's Access Payments	% of Retail (\$.07)
A (Nationwide carrier -- originates/terminates everywhere)	800	100	100	\$0.018760	100.00%	25.80%
B (Regional carrier -- originates in non-price cap/terminates everywhere)		50	10	\$0.035400	188.70%	50.57%
C (Regional carrier -- originates price cap/terminates everywhere)	400	25		\$0.014129	75.32%	20.18%
Access/Conv. Minute	\$0.013	\$0.032	\$0.051			
Access/Access Minute	\$0.007	\$.007 PC & \$.026 NECA	\$0.026			

* The Price Cap and NECA per minute access rates are averages based on July 2002 tariff filings. Price Cap rates do not include Presubscribed Interexchange Carrier Charges (PICCs)

- Carrier A has substantial market incentives to reduce or eliminate service in high cost areas.
- Carrier B faces a severe margin squeeze.
- Carrier C has a substantial artificial cost advantage.

Exhibit C2

Effect of High Access Charges on LD Competition – *MAG Order* plus USF Support to \$.0095 per Minute

Hypothetical Company	Price Cap - Price Cap MOU	Price Cap - NECA MOU	NECA - NECA MOU	Avg Access per Conv. Minute	% of Nationwide Carrier's Access Payments	% of Retail (\$07)
A (Nationwide carrier -- originates/terminates everywhere)	800	100	100	\$0.013900	100.00%	18.85%
B (Regional carrier -- originates in non-price cap/terminates everywhere)		50	10	\$0.016500	118.71%	23.57%
C (Regional carrier -- originates price cap/terminates everywhere)	400	25		\$0.013178	94.78%	18.82%
Access/Conv. Minute	\$0.013	\$0.016	\$0.019			
Access/Access Minute	\$0.007	\$0.007 PC & \$.0095 NECA	\$0.010			

- Carrier A's cost penalty for serving high cost areas is greatly reduced.
- Carrier B's margin squeeze is greatly reduced.
- Carrier C's artificial cost advantage is greatly reduced.

Senator BURNS. Thank you, Mr. Lubin.

And now we will go to Robert Orent, the President and CEO of Hiawatha Communications, and thank you for coming this morning.

STATEMENT OF ROBERT ORENT, PRESIDENT AND CEO, HIAWATHA COMMUNICATIONS, INC.

Mr. ORENT. Good morning, Mr. Chairman. I am a country boy who happens to come from Northern Michigan and also just happens to be the President and CEO of Hiawatha Communications, and I——

Senator BURNS. You do not have to feel bad about that at all.

[Laughter.]

Mr. ORENT. I do not, sir. I love it.

[Laughter.]

Mr. ORENT. I am particularly pleased to appear before you on behalf of hundreds of rural incumbent local exchange carriers that are members of ITTA, NRTA, NTCA, OPASTCO, and the Western Alliance. I would also like to request unanimous consent that a statement by the Rural Telephone Finance Cooperative be included as part of today's hearing.

Senator BURNS. They will be included.

Mr. ORENT. Thank you, sir.

[The information referred to follows:]

PREPARED STATEMENT OF THE RURAL TELEPHONE FINANCE COOPERATIVE

Introduction

The Rural Telephone Finance Cooperative submits this statement for the record in conjunction with the April 2, 2003 hearing on universal service of the Communications Subcommittee of the Senate Committee on Commerce, Science and Transportation. The Rural Telephone Finance Cooperative (RTFC) is a privately funded, member-owned, cooperative finance organization that provides financing exclusively to America's rural telecommunications industry. At the present time, RTFC has nearly \$5 billion of loans outstanding to its approximately 500 member telephone companies and their affiliates.

Universal Service Policy Distinguishes the United States

The policy of universal service and the programs to make it possible benefit all Americans. One of the key tenets of the Telecommunications Act of 1996 is the principle that quality access to advance telecommunications services should be made available to all regions of the Nation at rates that are just, reasonable and affordable. This is not simply a case of social justice, however. Our telecommunications system is unique in that, as a network, the addition of another user increases the value of the network to all and the loss of a user decreases the value to all. Residents and businesses in America's urban centers derive value from their ability to call and be called by those in rural and remote areas of the country. Our country's commitment to the economic and social benefit of this reality has contributed greatly to the creation and sustainability of the world's strongest economy.

RTFC's members are the small telephone companies and cooperatives that serve rural America. These companies are, for the most part, locally owned and operated. Eighty-five percent of rural telephone companies serve 10,000 or fewer customers. Their values are those that define rural Americans—hard work, integrity and commitment to service. But these values are not enough to build a modern telecommunications network. It also takes money. That is where RTFC has been able to make a contribution to America's rural telecommunications infrastructure—by providing debt capital.

Rural telephone companies have successfully met the challenge of bringing service to America's most sparsely populated areas. According to a recent National Exchange Carrier Association (NECA) study, 49 percent of rural telephone companies serve areas with customer density of ten or fewer customers per square mile. Fifty-three percent have service areas of over 200 square miles. Large service territories and few subscribers translate into high costs—costs that the Universal Service Fund (USF) plays an essential part in covering.

Universal Service Funding Is Essential To Keep Rural Americans Connected

Due to removal of subsidies from access rates, rural Americans have seen their telephone bills rise significantly. The NECA has found that residential subscriber rates rose 36 percent from 1994 to 2002. With the July 2002 increase in the Subscriber Line Charge cap to \$6.00 (going to \$6.50 in July 2003), and the initiation of the Interstate Common Line Support mechanism, this percentage increase will have risen dramatically by the end of 2003. Most rural residents have not seen any decrease in long distance rates however, as only 57 percent of rural customers have access to discount calling plans.

These increases to rural Americans' local service rates have not added one dollar to rural telephone companies' bottom lines, however. These changes were "revenue neutral." Rural telephone companies still rely heavily on the USF to recover their costs of putting in place the infrastructure necessary to provide modern telecommunications. This USF program was originally designed to keep the rates of America's most rural and high-cost customers affordable. Expansion of the program to fund new advanced services and competitors' services—while its funding base of interstate access traffic is declining—has placed USF under considerable pressure.

Rural communities, their residents and all Americans will suffer if USF is not adequate to allow rural telephone companies to recover their costs. Investment will dwindle and infrastructure will age and decline. Alternatively, local service rates will be increased to levels that will cause some to discontinue service. Under either scenario, rural telephone companies' ability to provide modern service to rural Americans will be diminished to the detriment of all Americans.

RTFC urges the Congress to assure that the commitment to comparable and affordable telecommunications service for rural Americans set out in the 1996 Act be upheld. The Universal Service Fund is essential to continued modern and affordable

telecommunications in rural America and preservation of the world's most technologically advanced network for the benefit of all Americans.

Mr. ORENT. Mr. Chairman, we are very concerned that State and Federal policy decisions are threatening the continued availability of high-quality modern telecommunication services to rural consumers. Many ill-advised decisions in several controversial court decisions have put the system of universal service support at risk. In addition, a series of critical decisions are pending at the FCC that will either make or break the cost-recovery mechanisms that make investments in rural infrastructure possible. If these issues are not dealt with in a manner consistent with the will of Congress when it passed the Telecommunications Act of 1996, rural consumers will be the unintended victims of a broken universal service system.

In our view, misguided regulatory decisions have rapidly swollen the size of the USF to a level that soon may be unsustainable. If the size of the USF reaches a point where further growth is unsustainable yet the number of carriers receiving support continues to grow, then no carrier will have the funding necessary to provide affordable, high-quality telecommunications services comparable to that received in urban areas.

More specifically, we firmly believe that a sustainable Universal Service Fund is being threatened by the ease in which some State commissions and the FCC have granted eligible telecommunication carrier designations in spite of the fact that competitive carriers do not face many of the same regulatory obligations we incumbents do.

Mr. Chairman, I believe very strongly that something must be done to rein in the FCC and the State commissions that have failed to accurately interpret the public-interest standard before designating ETCs. The current practice of liberally designating additional ETCs in the service areas of rural telephone companies is not sustainable based on the current rate of growth of CET support payments and the overall size of the USF fund. Fortunately, the Federal and State Joint Board on Universal Service has initiated a proceeding to review the Commission's high-cost universal service rules and the process for designating multiple ETCs.

In its public notice, the Joint Board has begun its consideration of whether it is advisable to establish Federal guidelines for States to use in designating ETCs. I would strongly suggest that State commissions and the FCC should adopt criteria to guide their consideration of ETC applications in rural service areas.

I hope that the Joint Board will be guided under the principle that USF is a scarce national resource that must be carefully managed to serve the public interest. By this, I mean that the USF should not be used to create artificial competition in areas served by rural telephone companies. I would also recommend that State commissions be encouraged to impose the same service quality standards, reporting requirements, and customer billing requirements that are imposed on ILECs.

Finally, ETC designations for competitors should be for the entire area that the incumbent carrier is also required to serve.

Mr. Chairman, I am hopeful that this subcommittee will convene a subsequent hearing that focuses squarely upon the issue of State

commission designation of ETCs in areas served by rural telephone companies. The impact of these as State regulatory decisions on the ability of rural consumers to continue to receive high-quality, affordable telecommunications services certainly demands such action by this committee.

Mr. Chairman, we also strongly believe that Congress should direct the FCC to follow the law when assessing contributions for the Universal Service Fund. We are concerned that the FCC will adopt a proposal for revising universal service contribution methodologies that does not comply with the act. Specifically, the Act requires that every interstate telecommunications provider contribute to the Fund on an equitable and nondiscriminatory basis.

Congress should also encourage the FCC to broaden the base of contributors to the Universal Service Fund. The Act allows the FCC to assess all providers of interstate telecommunications if the public interest so requires. We all agree that providers who compete with each other and provide the same functions should have the same contribution responsibilities. Your vigilant oversight of the FCC in this area would help to ensure a sustainable funding mechanism that provides stable and sufficient universal service support throughout rural America.

Mr. Chairman, in conclusion, there can be no denying the critical role that universal service plays in ensuring the future of our integrated network, a network that has been proven to be crucial and critical to the national and economic security of this country. Congress must continue to ensure that Federal and State regulators understand our Nation's longstanding commitment to a strong universal service policy and reaffirm its support for regulatory decisions that recognize that USF is a scarce national resource.

Thank you.

Senator BURNS. Mr. Orent, your full statement will be made part of the record. I know you summarized your statement, and I appreciate that, and I would hope that the other witnesses would, too. [The prepared statement of Mr. Orent follows:]

PREPARED STATEMENT OF ROBERT ORENT, PRESIDENT AND CEO,
HIAWATHA COMMUNICATIONS, INC.

EXECUTIVE SUMMARY

The Senate Commerce Committee, Subcommittee on Communications should be commended for convening an oversight hearing to consider the current universal service proceedings pending before the Federal Communications Commission (FCC). There is clearly much at stake for both rural telephone companies and rural consumers within the FCC's proceeding pertaining to the universal service contribution methodology and universal service portability.

Today, the Subcommittee will hear from a variety of witnesses that are deeply interested in the future of universal service and the outcome of both of these proceedings. Witnesses will identify a variety of concerns about the current universal service program and offer their recommendations on how the FCC should address these important proceedings. We believe there are serious threats to the long-term sustainability of the Federal Universal Service Fund (USF). If these issues before the FCC are not dealt with in a manner consistent with the will of Congress when it passed the Telecommunications Act of 1996, consumers will bear the costs of a broken universal service system.

I. Greater Oversight and Reform of the ETC Designation Process is Needed

The sustainability of the USF is severely threatened by the ease in which some state commissions have approved universal service support for wireless Competitive

Eligible Telecommunications Carriers (CETCs). In fact, since 1999, universal service support allocated to wireless CETCs has increased dramatically from \$500,000 in 1999 to a projection of approximately \$140 million in 2003. This astonishing growth in support to wireless CETCs is particularly troubling since these carriers are not held to the same regulatory obligations and serve standards faced by other carriers.

We ask that Congress reaffirm its strong admonition about financially supporting competition when it crafted section 214(e) of the Act. In enacting this section of the law governing the designation of multiple ETCs, Congress clearly recognized that supported competition would not always be in the “public interest” of areas served by rural telephone companies. Sadly, some state commissions and the FCC have ignored the intent of Congress and have designated additional ETCs without thoughtfully considering the factors that determine the public interest. Regulators have placed far too much emphasis upon the Act’s general goal of competition at the expense of rural markets and consumers. The result of state government-sponsored artificial competition in rural service areas has been a swollen USF that has put the entire universal service program at great risk.

II. The Senate Should Direct the FCC to Follow the Law When Assessing Contributions to the Universal Service Fund

It is very possible that the FCC will adopt a “connections-based” proposal for revising the universal service contribution methodology that does not comply with the Telecommunications Act of 1996’s requirement that every interstate telecommunications provider contribute to the Fund on an “equitable and nondiscriminatory basis.” We urge the Committee to direct the FCC to follow the law and ensure that interstate carriers continue to contribute their fair share to the Fund. We also believe the FCC should be strongly encouraged to take action that would broaden the base of contributors to universal service. The Senate has the opportunity to prevent further erosion of the contribution base. Your vigilant oversight of the FCC in this area would help to ensure a sustainable funding mechanism that provides stable and sufficient universal service support throughout rural America.

There can be no denying the critical role that universal service plays in ensuring the future of our integrated network—a network that has been proven to be critical to our national and economic security. Congress must continue to ensure that Federal and state regulators understand our Nation’s long-standing commitment to a strong universal service policy and reaffirm its support for regulatory decisions that recognize the USF as a scarce national resource. We hope that this morning’s hearing is the first in a series of actions by the Senate Commerce Committee to exert better oversight of these complex issues that directly impact the receipt of high-quality and affordable telecommunications services by millions of consumers nationwide.

INTRODUCTION

Mr. Chairman, members of the Subcommittee, my name is Bob Orent, and I am the President and CEO of Hiawatha Communications, which is an independently-owned telecommunications corporation headquartered in Munising, Michigan. Hiawatha Communications is the parent company of four local exchange telephone companies, namely Hiawatha Telephone Company, Midway Telephone Company, Ontonagon County Telephone Company, and Chippewa County Telephone Company, along with other subsidiaries, providing telecommunications services in the central and western Upper Peninsula region. Hiawatha Communications also owns and operates *Jamadots.com*, a new competitive high-quality Internet service that provides broadband services such as Digital Subscriber Line (DSL) service. Collectively, the operating companies serve more than 5,000 square miles of territory and approximately 15,000 customers.

I am very proud of Hiawatha Communication’s commitment to universal service by providing top quality telecommunications services at affordable prices, contributing to economic development, improving the quality of life, and otherwise serving the communities and citizens of Michigan’s Upper Peninsula. However, Hiawatha’s commitment to providing universal service is not unique. There are hundreds of independent incumbent local exchange carriers (ILECs) nationwide that are as just as committed toward fulfilling their universal service obligations on a daily basis. This morning, I am particularly pleased to appear before you on behalf of those hundreds of other ILECs that are represented by the Independent Telephone and Telecommunications Alliance, the National Rural Telecom Association, the National Telecommunications Cooperative Association, the Organization for the Promotion and Advancement of Small Telecommunications Companies, and the Western Alliance.

Mr. Chairman, we strongly support the goal of our Nation's universal service policy: to ensure that every American, regardless of location, has affordable, high-quality access to the public switched network and thereby benefits from a variety of telecommunications services. Rural ILECs are the embodiment of the universal service concept, having built the infrastructure that provides ubiquitous, high-quality local telecommunications service to some of the country's most remote and difficult to serve areas. The provision of a robust infrastructure in these areas would never have been possible were it not for the Nation's long-established policy of universal service and the USF.

However, we are very concerned that State and Federal policy decisions are threatening the availability of such high-quality, modern service to rural consumers. Such ill-advised decisions and several controversial court decisions have put the system of universal service support at risk.

Nine months ago, rural providers brought a warning to this subcommittee about a rural cost recovery system that was facing increasingly serious risks on several fronts. I regret to say that in the intervening nine months little has been done to effectively respond to these threats. Not surprisingly, these threats have not gone away. They have grown to the point that we may now be facing a true watershed for rural telecommunications.

A series of critical decisions are pending at the FCC that will either make or break the cost recovery mechanisms that make rural telecommunications possible. Given early indications, we are not at all confident that the FCC will get these decisions right without active oversight from Congress.

For example, in their zeal to meet the Act's goal of promoting competition, some state commissions and the FCC have not hesitated to allocate Federal universal service support to competing carriers in rural areas that clearly cannot naturally sustain more than one carrier. Some have even assumed that artificially supporting competition in rural areas, in and of itself, meets the Act's "public interest" requirement. Ignoring the law this way takes advantage of consumers nationwide that end up footing the bill when regulators abuse their authority.

Mr. Chairman, the dire consequences of such regulatory decisions have become more apparent in recent years. These decisions have rapidly swollen the USF to a level that may soon be unsustainable. For example, in 1996, the year the Act was passed, total funding for the support programs was \$1.7 billion. By the end of this year, funding for all programs projected to be approximately \$6.3 billion. Contributing to this dramatic growth in the USF is the fact that universal service support going to wireless Competitive Eligible Telecommunications Carriers (CETCs) has grown from less than \$500,000 in 1999 to a projection of more than \$147 million in 2003. It is estimated, that if all wireless providers nationwide were granted ETC status as part of this artificial "competitive" model that the annual level of the USF would grow by approximately \$2 billion. Thus, amazingly, over seven years, the Fund would have nearly quadrupled in size!

Our message this morning is very clear. If the size of the USF reaches a point where further growth is unsustainable, yet the number of carriers receiving support continues to grow, then no carrier will have the funding necessary to provide affordable, high-quality telecommunications services.

Who will suffer if the FCC and state commissions get it wrong? Just about everyone. Rural consumers will be denied the benefits of reliable, affordable communications service promised by the Act. Rural communities will also be disadvantaged. Investment in rural communities—both to maintain existing facilities and to deploy advanced services—will dry up. The more highly skilled jobs in rural communities will disappear. Finally, rural consumers will incur ever-growing costs for ever-dwindling benefits.

We are headed on a course for a serious train wreck and precious little is being done to avert it. Congress *must* exercise greater oversight of Federal and State regulatory decisions to protect our Nation's universal service program from these mounting risks. Without Congress' active oversight, the fundamental principles underpinning universal service—that all Americans deserve reliable, state-of-the-art telecommunications and that all Americans benefit when rural customers are connected to the network—are likely to be lost in a series of piecemeal FCC decisions designed to advance other, unrelated policy objectives.

The Economics of Rural Telecommunications

Mr. Chairman, for more than 100 years, independent local exchange carriers have provided local telecommunications service throughout rural America. For rural ILECs, universal service support has always been, and continues to be, a critical means of cost recovery that has made the provision of modern, affordable service possible in high-cost areas. Thus, if rural ILECs lose the ability or incentive to con-

tinue investing in their networks—or worse yet, if their existence is placed at risk—then some rural areas may be deprived of basic universal service where high-quality, reliable telecommunications services are available and affordable for all. Such an outcome would be completely at odds with the universal service principles that Congress enacted in the 1996 Act.

The universal service provisions of the 1996 Act indicate that universal service support should be used for infrastructure investment in areas where it would not otherwise be economically feasible to provide service at rates that are affordable and reasonably comparable to urban areas of the country. High-cost support should never be confused with a program simply to reduce the rates for telecommunications service charged to an individual end user.

Major Threats to Affordable Rural Telecommunications

Mr. Chairman, as I indicated earlier, universal service programs have successfully connected rural American households and businesses, schools and libraries, low-income families, and others to the public switched network. A strong universal service policy also provides other economic and social benefits for rural communities served by Hiawatha Communications and the hundreds of rural telephone companies nationwide. In communities in Michigan's Upper Peninsula and across the country, rural Americans have witnessed their communities thrive and prosper through rural economic development that depends on modern telecommunications. I am absolutely convinced that our Nation has already achieved many benefits from pursuing universal service as a national public policy goal. But again, it is critical that Congress exercises its oversight responsibilities to ensure a sustainable funding mechanism that provides stable and sufficient universal service support.

More than 7 years ago, we greatly appreciated the efforts of the "Senate Farm Team" led by Senators Burns, Dorgan, Stevens and others to ensure that key universal service provisions were ultimately enacted into law. However, from the moment when the Act was crafted until now, we have remained very wary of several elements of the provisions. Today, we believe that there are major threats facing the sustainability of the high-cost program.

States Must Take ETC Responsibilities More Seriously

First, we believe the sustainability of the universal service program is threatened by the ease in which some state commissions and the FCC have begun to create potentially vast new liabilities for the Fund and the Nation's consumers by approving universal service support for wireless CETCs—in spite of the fact that they do not face many of the regulatory obligations other carriers face. For example:

- They are *not* required to serve *all customers* in the service territory.
- They are *not* held to the same *quality of service* and *reliability standards*.
- They do not have *equal access* obligations.
- They do not receive support on the basis of *their own costs*.

Mr. Chairman, as you know, under the 1996 Act, in order to be eligible to receive high-cost universal service support, a carrier must first be designated as an Eligible Telecommunications Carrier (ETC) by a state commission or, in limited circumstances, by the FCC. In areas served by a non-rural ILEC, the Act requires state commissions and the FCC to designate additional ETCs, so long as the applying carrier meets certain prerequisites. However, in areas served by a rural telephone company, the Act provides state commissions and the FCC with the discretion to determine whether or not providing more than one carrier with universal service support would be in the best interest of those communities. More specifically, it requires state commissions and the FCC to find that the designation of an additional ETC in a rural service area is *in the public interest* before such a designation is made.

This additional requirement demonstrates Congress's recognition that supported competition would not always serve the public interest in the areas served by rural telephone companies. Unfortunately, in many instances, state commissions and the FCC have not been following the intent of Congress and have been quick to designate additional ETCs in rural telephone company service areas without thoughtfully and thoroughly considering all of the factors that determine the public interest. Our concerns are reflected in separate comments made recently by Commissioners Kevin Martin and Jonathan Adelstein.

Commissioner Martin explained how supporting competition in rural areas may not always be in the public interest when he stated:

I have some concerns with the Commission's policy . . . of using universal service support as a means of creating "competition" in high cost areas. I am

hesitant to subsidize multiple competitors to serve areas in which costs are prohibitively expensive for even one carrier. This policy may make it difficult for any one carrier to achieve the economies of scale necessary to serve all of the customers in a rural area, leading to inefficient and/or stranded investment and a ballooning Universal Service Fund.

Commissioner Martin's concerns underscore a key concern for rural telephone companies—the perfunctory grants of ETC designations by various state commissions and the FCC that do not take into consideration the potential costs of such decisions to rural consumers and to consumers nationwide who are the ultimate contributors to the USF. Fortunately, the Federal-State Joint Board on Universal Service has recently issued a Public Notice that will examine the process for designating ETCs and the Commission's rules relating to high-cost universal service support in study areas in which a competitive ETC is providing services.

In case after case state authorities and the FCC have granted ETC status to competitive carriers based on extremely loose public interest tests or tests that are inconsistent with the language and intent of the law. Notably, however, just last year, the Utah Supreme Court upheld a decision of the Utah Public Service Commission that denied ETC status for Western Wireless Corp. In upholding the PSC decision, the Court found that:

. . . the [Utah Commission] is not against competition per se, but rather, merely recognizes that in some instances competition in rural areas by multiple ETCs receiving state universal service support may not be in the public interest.

That is precisely what Congress's "public interest" requirement in rural carrier's areas says and means. Far too often, artificially inducing competition—or simply providing windfall payments to carriers for services that they are already successfully providing without support—has been assumed to be in the public interest. This flatly wrong interpretation has no place in the regulatory arena implementing the 1996 Act for rural markets. In the case of the rural markets served by my companies and those of my rural company colleagues, these entire communities are typically already receiving high quality, affordable communications services and the existing provider is doing all it can to provide advanced capabilities. Owing to the FCC's and the state's misguided interpretations and implementation of the 1996 Act, today we are at the point where pressures on the high-cost program have grown to the degree that we are now very concerned about its long-term viability. Clearly, for the public interest to be served, it will be necessary to demonstrate that the benefits of supporting multiple carriers will exceed the costs created by supporting multiple networks.

These concerns are also apparently shared by FCC Commissioner Jonathan Adelstein, who recently stated:

The public interest also demands that regulators seriously consider whether a market can support more than one carrier with universal service. If not, then new designations shouldn't be given as a matter of course just because they meet other qualifications.

Commissioner Adelstein too is simply reading what the 1996 Act says and requires.

Mr. Chairman, although we have never agreed with the concept of allowing multiple carriers in a market served by a rural telephone company to receive universal service support, we had hoped that the safeguards in the law would prevent the duplicative support provisions from doing unintended harm. In fact, we have always noted that the great majority of rural markets that are served by our members are not, and may never be, in a position to sustain more than one carrier. Artificial competition—that is competition that is based upon a business plan relying on duplicative universal service support—is not market driven competition at all and should be discouraged, not encouraged. Technically, the statute contemplates multiple carrier support in non-rural telephone company areas and even requires it in the large urban-centered markets. In our view, however, the provision allowing an existing support recipient to relinquish its ETC designation voluntarily when a new recipient becomes designated indicates that the congressional intent behind the provision was that new entrants into a market would be making a genuine, carrier-of-last-resort commitment to the market in order to receive universal service support.

The legislative history leading to the creation of the section of the statute that provides the states with the responsibility of making ETC determinations shows that the Congress believed state authorities would be in a better position to make ETC determinations than the FCC. State policymakers, after all, would have the best information with regard to the needs of their respective rural markets and would have a vested interest in ensuring such markets were efficiently and well

served. Unfortunately, to a large extent state policymakers have simply followed the direction and directives of the FCC, without a great deal of thought being given to their individual, unique circumstances.

The FCC first tried to prevent states from adopting any additional requirements for carriers seeking to qualify for support. The 5th Circuit decided that the law did not permit this prohibition. The FCC has, since then, issued an unnecessary declaratory ruling threatening to preempt state requirements the FCC perceives as obstacles to the publicly-supported “competition” it wants to foster.

Mr. Chairman, we urge Congress to work with us and the Federal-State Joint Board on Universal Service to make it clear that ETC designations are to be taken seriously and that the responsibilities associated with receipt of this designation must be equal to the carrier of last resort level of commitment demanded of incumbent carriers. Providing support to a carrier that is unwilling to provide true, ubiquitous universal service is wasteful and serves no one well. The fact of the matter is that we incumbents have always provided real value to our customers and to the nationwide end-user contributors in return for our ETC designations, and we would not have it any other way. Nevertheless, Congress should no longer sit still and watch others take advantage of this critical program.

Providing Support for Multiple Carriers at the Incumbent Carrier's Cost

Mr. Chairman, I have spoken about my disappointment over state commission misinterpretation of the “public interest” when designating more than one ETC in an area served by a rural telephone company. However, the states are not the only ones running up the costs for the universal service program without increasing the benefits. The FCC is also responsible. One of the most controversial and costly FCC actions “implementing” Congress’s universal service requirements is its revision of a pro-consumer policy into a consumer-funded windfall for competing carriers in rural areas. This unjustified consumer burden came about because the FCC uses the incumbent local telephone company’s actual costs for providing a line to its customers to calculate the universal service support for competing carriers.

The FCC originally said that it would use its proxy model, based on an imaginary state-of-the-art lowest-cost network for rural carriers’ support. However, its Rural Task Force, made up of representatives of consumers and all sorts of carriers, determined that the proxy model simply would not work for the extremely varied rural telephone companies and the differing conditions in their service areas. And we agree. Nevertheless, the FCC still wants to force rural companies into its misshapen proxy mold. Fortunately, for now it is still using actual costs, which accurately measure the need for support for incumbents under the current formulas.

Mr. Chairman, fixated on the principle of “competitive neutrality” it had added to the list of principles Congress adopted, the FCC decided to make support “portable.” By this, the FCC meant that universal service support for high cost, rural, and insular areas would be shifted to a competitive ETC that “wins” or “captures” a customer from an ILEC. It later spoke of support for “new” customers, too. The idea is that the new eligible carrier receives the same level of universal service support for a customer as the ILEC would have been eligible to receive for serving that customer.¹

The FCC’s rationale was that “paying the support to a competitive eligible telecommunications carrier that wins the customer or adds a new subscriber would aid the entry of competition in rural study areas.”² The FCC simply brushed aside the statutory language, ignoring that section 254’s requirements for “sufficient,” “predictable” and, above all, “specific” support are totally at odds with basing support on *another carrier’s* cost-specific support.

Basing support on the incumbent’s actual costs means that the competing carrier’s subsidy per line has no link whatever to its own costs or rates. Thus, the support is not “specific” and is almost certain to be more than “sufficient,” since unlike ILECs, competitors can choose where to serve and where to seek support.

As a result, wireless carriers get support based on the high costs of providing a copper or fiber line to a remote ranch in Montana. However, the economics of how wireless carriers incur costs are entirely different, and they do not need to install lines to the customer’s premises. They also get support based on the greater costs

¹*Federal-State Joint Board on Universal Service*, CC Docket No. 96–45, *Access Charge Reform, Price Cap Performance Review for Local Exchange Carriers, Transport Rate Structure and Pricing, End User Common Line Charge*, CC Docket Nos. 96–262, 94–1, 91–213, 95–72, Fourth Order on Reconsideration in CC Docket No. 96–45, Report and Order in CC Docket Nos. 96–45, 96–262, 94–1, 91–213, 95–72, 13 FCC Rcd 5318, 5364–5365, para. 79 (1997) (4th Order on Reconsideration), citing *Federal-State Joint Board on Universal Service*, CC Docket No. 96–45, Report and Order, 12 FCC Rcd 8776, 8932–34, 8944–46 (1997) (Order).

²Order, 12 FCC Rcd 8944, para. 311.

per line for necessarily small switches provided by small incumbent carriers in areas with few subscribers, regardless of the size, location, or efficiency of their switches or the scope of their service areas. The mismatch between support and costs has become even greater now that the FCC has adopted Interstate Common Line Support (ICLS) to replace cost recovery that ILECs used to get via their access charges to long distance carriers. However, while the incumbents lowered their access charges to qualify for support, the competing subsidized carriers claim that they must get the additional support per line without changing their rates or services at all.

Mr. Chairman, the claim that support is necessary to bring competitors into rural areas is not supported by the facts. What has generally been the case, for example, is that the additional support is claimed by a rural cellular carrier that is already serving the area where it draws support. Under current FCC policies, it immediately obtains support at nationwide consumers' expense for the service it is already successfully providing to paying customers. The lure of support for nothing in return is quickly inducing wireless carriers to cash in on the consumer-financed bonanza. Recent reports by investment analysts of the "high margin" subsidies that wireless carriers may obtain for their lines in rural areas will further pressure more prudent wireless providers to seek this windfall as well.

Incumbent local phone companies serve as the so-called carrier of last resort in their service areas. This means that they must provide service in response to any reasonable demand, including, for example, when competitors cease to provide service, and cannot discontinue service without regulatory permission. These obligations are key safeguards against any community or consumer losing the ability to connect into the public switched network at just and reasonable rates.

In contrast, the wireless carriers that are beginning to line up for the right to draw support are also the strongest opponents of any requirements that competing subsidized carriers provide proven value to consumers in return for the support they receive. These carriers claim that section 332(c) of the Act, which exempts them from state rate and entry regulation, also bars any state from requiring them to meet rate level requirements to justify their subsidies under universal service support programs. They expect the general public to cover some of their costs of providing service under the national policy of providing universal service in high-cost markets. But they refuse to recognize the difference between state regulation—setting rates or placing obstacles that prevent them from providing competing service at all—and requiring them to provide value to the Nation's ratepayers to justify the support they receive. These carriers even complain that it is against government policy to ask competing carriers to calculate their costs of service to qualify for support from nationwide users of the network. It is as if applicants for hurricane disaster assistance took the position that they could not be asked to demonstrate that they had been affected by hurricane damage because financial information and information about the condition of their property is private.

Under section 253 of the Act, carriers are free to enter and provide competing service in markets throughout the Nation without regulatory obstacles. However, it is not forbidden "regulation" to ask that they justify the need for support, and how they use such support, under the consumer-centered purposes for which universal service support has been established. Nor should the section 332 prohibition on requiring wireless carriers to provide equal access to competing providers of long-distance service mean that they are shielded from meeting that requirement if they voluntarily seek high cost subsidies. It is absurd to equate regulatory requirements that apply as a condition for providing service as a carrier with conditions that attach only to carriers that choose of their own volition to seek universal service support.

Mr. Chairman, section 254(e) of the Act requires that carriers that obtain Federal universal service support use it only for the legitimate universal service purposes for which it is intended. Since the support for incumbents is based almost entirely on their own past actual investment and expense payments or reductions in other rates, it is clear that the support has been used for purposes covered by the cost-based support formulas. The use to which competitors will put support based on the *incumbents'* actual spending record, cannot be discerned from the formulas or records. Their unsupported self-certification that they use the support for appropriate purposes is suspect, at best, when they need not capture customers, add new customers, change their rates, increase their investments, improve their services or make any other legitimate use of the windfall payments they receive. Congress owes it to the Nation's telecommunications customers that fund the Federal universal service programs (a) to base each ETC's support payments on its own cost of providing service and (b) to verify that non-cost-based payments are actually put to use for the statutory purposes.

Finally, the argument of wireless carriers that the definition of universal service must not be upgraded unless they can meet the new standard is a perversion of the pro-consumer foundation on which the national universal service policy rests. While competitive local exchange carriers (CLECs) have tried to provide broadband in their markets, wireless carriers that are entering markets on the basis of what universal service subsidy is available put their own interests ahead of the consumers Congress sought to benefit. To make the level of support available to particular carriers a test for whether and when consumers should be able to count on the evolving definition of universal service the law requires is an affront to the statutory principles of reasonably comparable urban and rural rates and services, including advanced telecommunications and information services and to the section 706 objective of universally available access to broadband services. Although it is too early to change the definition at this point in the development of the broadband marketplace, who can qualify for support will never be a reasonable standard for evolving the supported universal services within the definition.

The FCC Should Follow the Law When Assessing Contributions to the Universal Service Fund

Mr. Chairman, the FCC is currently considering three different “connections-based” proposals for revising the universal service contribution methodology. The first proposal would impose a flat monthly fee for each end-user connection and assess a “minimum” contribution from each interstate telecommunications provider regardless of whether the carrier provides connections. The second proposal would split “connections-based” based contributions between switched access and interstate transport providers. The final proposal would assess contributions on the basis of telephone numbers assigned to end users. We are very concerned that through these proposals the Commission is considering possibly adopting a new contribution methodology that would violate the requirement set forth in the 1996 Act that calls for “equitable and nondiscriminatory” contributions from every interstate telecommunications carrier.

In addition, we also all strongly believe that any reform of the universal service contribution methodology should expand the base of contributions to the Fund. As you know, the universal service system has been funded by a broad-based national system of industry contributions. The traditional contribution base—the long distance market—has steadily declined, eroding the funding base for universal service. Alternatives to long distance—wireless, e-mail, Internet Protocol (IP) telephony and their customers have not been asked to contribute their fair share to alleviate the shortfall. We are very concerned that the proposals currently pending before the FCC would fail to broaden the contribution base sufficiently, and fail to ensure the stability and sufficiency of the USF for the long-term.

Mr. Chairman, the manner in which contributions are assessed for the USF is a very complex and controversial issue. In fact, the associations that I represent this morning differ on how to solve the current universal service contribution dilemma. One view is that only the “connections-based” proposal which would split contributions between switched access and interstate transport providers could be made to comply with the Act’s requirement of “equitable and nondiscriminatory” contributions from all interstate telecommunications carriers. Since all interstate telephone calls require both a connection to a local distribution network and a carrier equipped to transport these calls across state lines, splitting contributions between both of these carriers would be equitable and nondiscriminatory.

Other telecommunications advocates are not convinced that the Commission should give further consideration to any of the “connections-based” USF assessment proposals. Their alternative position recommends that the FCC allow sufficient time to determine whether the modified revenues-based USF contribution mechanism it adopted last year could be sustainable for the future. Some industry stakeholders with this view also maintain in part that the FCC should refrain from further changes to the USF contribution mechanism until it has implemented final rules in its wireline broadband classification and universal service portability proceedings.

Although there is more than one view among the associations about whether and how to address the USF contribution issue, I can assure you in the strongest possible terms that we are unified in our view that any further modifications by the Commission to the contribution methodology *must* be consistent with the statute’s clear requirement that all interstate telecommunications services contribute to the USF on an equitable and nondiscriminatory basis. Regardless of whether the FCC adopts the proposal for splitting contributions between switched access and interstate transport providers or extends the operation of its interim modified revenues based plan, the associations all agree that interstate interexchange carriers have to remain principal contributors.

Mr. Chairman, we all agree that universal service support needs to be sufficient and sustainable and should be fair to all providers and users of all kinds of networks. We are aware of growth in the Fund and concerned about shifts in the types of interstate services consumers are utilizing. These developments have created a serious issue about how to prevent erosion and evasion of support mechanisms. Thus, we firmly believe that the FCC needs to assess the broadest possible list of contributors to keep each carrier's contribution and the amount it needs to recover from its customers as small as possible.

We need to emphasize that the gradual but ever-growing use of broadband platforms and Internet Protocol (IP) networks play a growing role in the instability of the contribution base. Consumers use IP networks in a variety of ways (access to the World Wide Web, e-mail, instant messaging, Internet telephony) and via various platforms (cable, wireless, satellite) to substitute for interstate calls on the public switched network. As this "Internet substitution" grows, traditional interstate revenues providing the funding base for universal service will diminish. And there will be little offsetting gain, since presently only wireline telecommunications carriers are required to contribute on the basis of revenues earned from Internet access service. All other Internet access providers using other platforms remain exempt from the obligation.

Mr. Chairman, Federal law allows the FCC to assess all providers of interstate "telecommunications" if the public interest so requires, even if they are not common carriers. We all agree that all providers that compete with each other and provide the same functions should have the same contribution responsibilities. This means that cable modem providers and other information service providers that provide their own transmission should contribute, just as ILECs presently contribute for their transmission role in providing Internet access. This also means that wireless carriers need to be assessed on a fairer basis than even the "modified safe harbor" adopted by the Commission last year.

More specifically, in reassessing who must contribute to the Fund, Congress should insist that interexchange carriers, Internet access providers, wireless carriers, bundled service providers, payphone providers, dial-around services, and IP telephony providers, as well as local exchange carriers *all* contribute to the USF. Broadband service providers, whether considered information service providers or telecommunications service providers, also should be included as supporters of universal service. Finding an equitable way of assessing contributions to universal service support on carriers, and—as I just discussed—broadening the base of contributors to universal service are significant problems the FCC needs to resolve to make universal service support funding sustainable.

Universal Service Is Good Public Policy For America

Mr. Chairman, the high-cost component of the universal service program handles approximately \$3.3 billion in annual carrier-to-carrier support transactions, which represents slightly more than half the amount that is channeled through the overall fund each year. The high-cost component is a "safety-net" of sorts for rural carriers and their subscribers, but it is also a tool to ensure that all Americans enjoy the benefits and security of a nationwide integrated network. Congress and successive Administrations have wisely recognized the value of this component of the program and now, above all else, need to take steps to ensure its ongoing ability to function according to statutory intent.

The high-cost element of the Fund is used to build telecommunications "platform" infrastructure. Without a telecommunications platform, our schools and libraries, rural health care, and lifeline and link-up programs, and millions of rural Americans, have nothing. Modern telecommunications infrastructure in rural America enables diversity of education, health, and other social services comparable to those in urban areas.

Mr. Chairman, our Nation's first priority for rural areas should be to provide a stable environment for continued telecommunications investment. Technologies and businesses come and go. But one of the most important ways rural Americans have benefited from universal service is that it has sustained a telecommunications commitment to rural communities for decades. "Rural telephone companies," as defined in the 1996 Act, have become an integral part of rural communities throughout America and have remained economically viable in these high-cost areas due, in large part, to strong universal service policy.

In sum, a strong universal service policy is still needed today to ensure a stable environment that encourages continued telecommunications investment in rural America. Incumbent rural telephone companies have met the challenge of deploying telecommunications infrastructure in high-cost rural areas. With a strong universal service policy, they can continue to help rural communities and rural Americans re-

alize diversity of education, improved health and other social services, and economic development through modern telecommunications.

Senator BURNS. Mr. Matthew Dosch, of Comporium Communications, Rock Hill, South Carolina.

**STATEMENT OF MATTHEW DOSCH, VICE PRESIDENT,
EXTERNAL AFFAIRS, COMPORIUM GROUP**

Mr. DOSCH. Good morning, Mr. Chairman.

My name is Matthew Dosch.

Senator BURNS. See if you can talk like my ranking member here.

[Laughter.]

Mr. DOSCH. I am afraid we do not sound too much alike on that score.

[Laughter.]

Mr. DOSCH. My name is Matthew Dosch, and I am Vice President of External Affairs of the Comporium Group based in Rock Hill, South Carolina. Comporium is a relatively new trade name for us, but we are a group of rural incumbent local exchange carriers that have been providing telecom services to communities in upstate South Carolina for nearly 110 years. Rock Hill Telephone Company, Fort Mill Telephone Company, and Lancaster Telephone Company collectively serve 105,000 access lines.

I am very pleased to appear before you today on behalf of the United States Telecom Association. As you know, USTA is comprised of small, mid-sized, and large telephone companies. I currently serve as the chairman of USTA's mid-sized company caucus.

It has been apparent to telephone companies of all sizes that while our Nation's commitment to universal service has never been more critical, the Federal program that is meant to maintain that commitment is in serious jeopardy. This is not just an academic interest on my company's part. The country's universal service policy has allowed Comporium to extend a robust telecommunications network built on digital switching and a fiber backbone to rural communities such as Fort Lawn, South Carolina, and Heath Springs, South Carolina, each with a population of around 850, as well as the much less populated rural areas surrounding them.

Mr. Chairman, Comporium and other telephone companies grew to recognize that in the time since universal service policy was last addressed by Congress in the Federal Telecom Act of 1996, several trends have emerged that are straining the present system to the breaking point. These trends include, first, a limited and shrinking base of interstate telecom revenues on which to assess contributions into the existing program; and, second, a misguided effort to use universal service to incent competition for competition's sake in high-cost areas with little regard for the overall public interest rather than to assist facilities-based infrastructure providers to offset the high costs of extending their networks to those areas.

If these trends are not addressed, the entire universal service system will simply become unsustainable, and that will have dire consequences for our customers who happen to live in rural high-cost areas. Recognizing this possibility, USTA member companies of all sizes came together last winter in an attempt to identify a solution to this problem.

Mr. Chairman, the principles I am about to outline for you represent a true consensus position within the association. They are the direct result of serious, good-faith negotiations between the Bell companies, mid-sized companies such as my own, and USTA's sizable and active small-company community. The resulting policies reflect a strong desire on the part of telephone companies of all sizes to seek common ground so that we can continue to provide affordable universal service to all of our customers regardless of where they may live. We believe the adoption of these principles by policymakers will result in a strong, sustainable, and appropriately targeted universal service mechanism.

First, Congress should direct the States to make reasoned public-interest findings before designating additional eligible telecommunications carriers. ETCs should be true providers of critical infrastructure in high-cost areas. If a State determines that designating additional ETCs in a given high-cost area in order to subsidize competition is in the public interest, that State should be responsible for funding that competition.

Second, regulatory status should not affect the carrier's ability to receive universal service support. Local exchange carriers should be given the option of being deregulated on a date certain since increased competition, for the most part, has replaced the need to regulate retail and wholesale rates in most markets. To the extent that a LEC is deregulated, universal service support should help to fund its infrastructure platform, not dictate the rates and services over that platform.

Third, Congress should give the FCC the authority to impose a universal service fee on a broader base of interstate and intrastate telecom products and services and target receipts from that fee to high-cost universal service, exclusively.

Fourth, rates in high-cost areas should be re-balanced among composite end-user rates, inter-carrier compensation, and universal service. Composite end-user rates should be no lower than the statewide average. And additional revenue replacement necessary due to inter-carrier compensation changes should be accomplished through changes in universal service support.

Finally, Congress should ensure that support is based on actual costs. For large LECs, the FCC has employed a cost-recovery methodology that does not permit the recovery of the actual costs incurred to provide infrastructure in high-cost areas. In the future, universal service support should be based on actual costs for all companies.

Thank you, Mr. Chairman. I would ask that my written testimony be submitted for the hearing record, and I look forward to any questions you may have.

[The prepared statement of Mr. Dosch follows:]

PREPARED STATEMENT OF MATTHEW DOSCH, VICE PRESIDENT, EXTERNAL AFFAIRS,
COMPORIUM GROUP

Good morning, Mr. Chairman and members of the Subcommittee. My name is Matthew Dosch, and I am Vice President of External Affairs of the Comporium Group, based in Rock Hill, South Carolina. Comporium is a group of rural incumbent local exchange carriers (ILECs) that have been providing telecommunications services to communities in upstate South Carolina for nearly 110 years. Rock Hill

Telephone Company, Fort Mill Telephone Company, and Lancaster Telephone Company collectively serve 105,000 access lines.

Although “one-stop shopping” has become something of an industry cliché, Comporium has always sought to make its customers’ lives easier by providing a wide variety of the latest telecommunications products and services. From local and long distance telephone service to high-speed Internet access, wireless, cable TV, and security, Comporium continually strives to provide our customers with affordable solutions to their communications needs.

I am appearing before you today on behalf of the United States Telecom Association (USTA). I currently serve as Chairman of the Mid-Size Company Caucus within USTA. My mid-size company brethren, along with the small company and large company members of USTA, have worked tirelessly throughout the winter to forge the consensus positions on universal service that I am pleased to share with you today.

Charting a Stable, Sustainable Future

For more than a century, our Nation’s telecommunications network has helped define the fabric of American life. Like the electrification of the countryside, the Nation’s commitment to universal service—seeing essential telecommunications reach every corner of the country—has played a major role in America’s economic and social development. The ubiquitous presence of a telephone in virtually every American home stands as one of the Nation’s landmark achievements of the 20th century and a testament to the efficacy and value of the universal service program.

Universal service support exists to bring essential telecommunications service to parts of the country where the market alone cannot support its presence. By easing the extraordinary costs of reaching sparsely populated areas, universal service helps ensure that all Americans have affordable, reliable access to a dial tone and the security and opportunities it represents. With the Nation’s evolution from an industrial to an information economy and with the country’s escalating security concerns, reliable access to essential telecommunications has never been more important. Yet the funding mechanism that ensures this broad access today is in peril—undercut by telecommunications policies that discourage investment, undermine the evolution of healthy telecommunications markets, lavish resources on companies that do not face the same obligations as incumbent wireline providers, and turn a blind eye to new platforms that now regularly compete for consumers’ communications dollars, but that do not contribute their fair share to the universal service support funding mechanisms.

Fortunately, there is growing recognition of the value and vulnerability of Universal Service Funding mechanisms. The Federal Communications Commission (FCC) recently adopted an interim funding mechanism that makes incremental progress. It also has proceedings underway to contemplate long-term solutions to perpetuate the program. This morning, I would like to examine the trends that have placed Federal universal service support in jeopardy today, as well as solutions to ensure the fair and fiscally sound continuation of this vital program.

The Core Challenge: A Costly, Unsustainable Status Quo

For most of their existence, universal service mechanisms have focused on mitigating the high costs associated with delivering vital telecommunications services and infrastructure to rural, insular and remote parts of the Nation. With the Telecommunications Act of 1996 (1996 Act), however, Congress set universal service on a perilous path of ‘mission creep.’ Rather than a focused cost-recovery mechanism aimed at helping facilities-based infrastructure providers offset extraordinary costs toward the public benefit, universal service has become a costly and sprawling mechanism rooted in the well-intentioned, but overly simplistic philosophy that supporting competition for competition’s sake must be even better. Unfortunately, this has been implemented without a thorough and fair evaluation of the public interest.

Seven years after the passage of the 1996 Act, this policy alteration—and how it was executed—has set off a chain reaction that now has called the entire program’s sustainability into question. As a result of this alteration, the number of companies successfully gaining universal service support has exploded. In fact, if the trend continues unabated, experts predict the high-cost fund will, due to this factor alone, grow by \$2 billion over the next four years.

Inflating the Balloon

The primary driver inflating the costs associated with Universal Service are provisions of the 1996 Act that open up support to multiple providers in the same service area that successfully secure status at the state level as Eligible Telecom Carriers (ETCs). For incumbents to gain universal service support, they must thoroughly document the costs of their telecom infrastructure, promise to deliver a specified list

of services, and most importantly, continue to fulfill the regulatory, public safety, and national security expectations and obligations of State and Federal officials. So while incumbent providers have access to a cost-recovery mechanism, non facilities-based providers are offered what amounts to a windfall. They get the money, regardless of whether they are truly fulfilling the obligation of being a critical infrastructure provider, and potentially the sole critical infrastructure provider, in a particular area. This perpetuates a fundamental disparity rampant throughout today's outdated system of wireline regulation: rewarding those who fail to assume the full obligations of a true carrier of last resort and punishing those that actually carry out the Fund's initial purpose of delivering the infrastructure that ensures reliable, affordable access to basic services in every community across the country.

The expensive universal service mission creep undermines the political viability and economic sustainability of the entire program. With far more companies participating at a price tag in the billions of dollars, taxpayers and legislators see diminishing returns on their rising investments because the benefits of support for multiple carriers in each service area rarely outweigh the explosion in costs.

There also is a strong argument to be made that this subsidy-heavy approach undermines the evolution of healthy, sustainable markets in rural America, as well as the rollout of leading-edge services. The way rural markets develop, typically one business determines that there is adequate 'critical mass' to support their business. Then, over time, the opportunity and the community grow to the point where others are attracted into the area and competition ensues. In the case of telecom, universal service support has skewed the economics of what attracts companies to higher cost areas. A mechanism that lures multiple providers and subsidizes inferior service undermines this natural evolution, all but ensuring long-term dependence on government subsidies and weakening the growth of a sustainable market and the investment that typically accompanies it.

Cherry-picking Further Punishes True Carriers of Last Resort

Another challenge to the current USF structure is the effort in some states to reduce the size of USF service areas in places served by rural telephone companies. This is yet another attempt to use universal service to promote competition rather than simply access to affordable, essential services. For example, CenturyTel is fighting such an effort in Colorado. States' segmentation of service areas to a granular level encourages competitors to selectively enter areas with higher revenue customers, leaving incumbents (which have carrier of last resort obligations for the broader service area as a whole) with the least profitable customers of all.

Funding competition that cannot be supported by normal marketplace economics, and handing out vast amounts of resources to companies without the obligations and expectations that accompany service provided by the incumbent LEC, clearly call into question the future viability of the program. In fact, the purse strings are perceived to have become so loose in recent years that organizations that target government waste are starting to zero in on high-cost USF support, making it imperative that the Fund be operated in a more responsible and restrained manner in the future, in order to ensure that its important core work continues.

Spreading the Burden Fairly

The current universal service approach has undermined the program's initial purpose—delivering to remote communities the economic opportunities and security of a dial tone. However, like U.S. telecom policy in general, the universal service program is behind the times in making another crucial acknowledgement: In the 21st Century telecom marketplace, voice telephony is no longer the sole domain of incumbent local exchange carriers.

Consider these core facts:

Today, one in five Americans use their cell phone as their home phone; half of all Americans, according to Forrester Research, will follow suit in five years' time;

The cable industry is adding 100,000 new voice customers every month; and Cox Cable today is the 12th largest phone company in the Nation;

Internet-based telephony is beginning to go mainstream; in fact, the U.S. Department of Commerce is in the process of transferring its entire telephone system to Internet-based telephony.

Even in the traditional wireline market, 93 percent of households have at least two local providers serving them.

Given that the 21st Century telecommunications marketplace has diversified, so too must the pool of contributors to universal service. This is the only path to ensur-

ing a platform neutral approach in which all participants in the marketplace contribute, so no set of companies is put at a disadvantage.

The Current Mechanism is Not Sustainable

The current mechanism used to collect Federal universal service support as established in Section 254 of the Telecommunications Act of 1996 is not sustainable. Congress, when it passed the 1996 Act, had multiple goals. First and foremost, however, it wanted to promote local telephone competition, even in rural areas where the provision of service is extremely costly and without universal service support would be prohibitively expensive to the consumer. Density, or more appropriately, the lack of density, is the costly rural problem—there are more telephones in a typical Manhattan office building than there are in the entire service area of many rural telephone providers. Nonetheless, Congress specifically provided for the possibility of multiple non facilities-based recipients of Federal universal service support—this was in furtherance of its primary policy goal of local telephone competition in all areas, including rural ones. In other words, universal service support would, pursuant to the 1996 Act, be used to facilitate the entry of new local telephone providers even in areas served by rural telephone companies—this then is the “mission creep”. Section 214 of the Communications Act of 1934 was amended by the 1996 Act to authorize multiple “eligible telecommunications carriers” (ETCs) to be the recipients of universal service support in rural areas, with state commission approval. The funding source for this universal service support is “telecommunications carriers that provide interstate telecommunications service.” Consequently, the states have no reservations about authorizing additional ETCs, given that they have no responsibility for raising the universal service support funds that will be distributed in their states. Only the FCC has this fundraising duty, and the courts have instructed the FCC that only interstate revenues may serve as the basis for assessing Federal universal service support contributions.

This statutory combination of universal service support as a local telephone competition facilitation device, coupled with the limitation on universal service support contributions to only narrowly based interstate revenues, places extreme pressure on these Federal universal support mechanisms. In and of themselves, these two factors alone will render the existing Federal mechanisms unsustainable, in that demands for universal service support funds are increasing far more rapidly than interstate revenues are growing. Over the next five years, USTA estimates that demands for universal service support will increase substantially, from \$7.4 billion to \$11.9 billion, while the interstate service revenue funding base remains flat at best.

In addition to these two factors, however, there are other developments in the telecommunications marketplace that make the current Federal universal service support mechanism truly unsustainable. First, for decades, states have established a host of implicit subsidy mechanisms and telecommunications rate determinations that need Federal universal service support in order to be maintained. Devices of this sort can exist in the non-competitive telecommunications environment that existed when they were originally established, but that era has passed. Rates in high cost areas must be rebalanced. Second, popular flat rate, all-distance pricing plans for voice services are rendering distinctions between interstate and all other telecommunications services meaningless and thus unworkable as a basis for collecting universal service support funds going forward. Third, the FCC is currently examining the regulatory classification of a number of “voice over Internet protocol” services (VOIP). The outcome of its review could have a dramatic effect on the base of services which will be available to support the universal service programs. If VOIP services are allowed to avoid contributing to universal service, this could skew demand in favor of these services, making it increasingly costly, if not impractical, for traditional telecommunications service providers to continue funding universal service support even at existing levels.

Not only will these developments in the telecommunications marketplace impact the base of contributions that fund universal service, but the current system of intercarrier compensation, particularly access charges paid to local carriers from interexchange carriers, is slowly collapsing under the weight of technological change and creative arbitrageurs. Many carriers rely on interstate and intrastate access charges to recover a significant portion of the costs of their networks. The deterioration of the access charge system must be recognized and managed in an orderly way so that carriers will still be able to recover their costs and continue to invest in their networks. An appropriate transition should be developed to move from the current system of intercarrier compensation to a uniform intercarrier compensation plan under which carriers would recover their costs from end users (through affordable and reasonably comparable rates) and the universal service mechanism. In many high cost study areas, end users will not be able to bear the totality of this added

burden. The universal service mechanism will be called upon to fill in that gap. This necessary extension of the mechanism is consistent with its current goals and structure but certainly has the potential to increase the demand for Universal Service Funding.

UNIVERSAL SERVICE REFORM—WHAT SHOULD CONGRESS DO?

Support Recipients Must Have an Equality of Obligations

The policy of using universal service support as a means to promote competition has proven to be an expensive failure. This artificial approach simply adds to the cost of the universal service program. States should make reasoned public interest findings before designating additional ETCs, with full consideration of an equality of obligations on carriers and equality of expectations of all of the consumers in the subject service area. A recipient should be required to serve an entire high cost area—not just the least costly part, as is often the case today.

Universal Service Support Should Not Create a Parallel de facto Regulatory Regime

Universal service support should be used to provide incentives for continued investment in and rehabilitation of high cost study area infrastructure and to help recover the actual costs of such networks (not lines or services). Since increased competition, for the most part, has replaced the need to regulate retail and wholesale rates in U.S. telecommunications markets, exchange carriers should be given the option of being deregulated on a date certain. Regulatory status should not affect a carrier's universal service support and such support provided to a deregulated carrier should serve to help fund an infrastructure platform, not dictate the rates and services offered over that platform. This should apply whether a carrier elects the deregulation or continued regulation model. Exchange carriers that remain regulated should be given the flexibility to package and price service to meet consumer needs, and for rate of return carriers, NECA (National Exchange Carrier Association) pooling options should continue.

Broader Support Base

Congress should give the FCC the authority to impose a support fee on a broader base of telecommunications products and services. By broadening the base for universal service support to all telecommunications products and services, both technological and competitive neutrality will be achieved. The receipts from these fees must be targeted exclusively to universal service support purposes in a manner similar to the specifically targeted and Congressionally mandated assessments for highways and airports.

Rate Rebalancing

Rates for telecommunications services should be comparable throughout a given state. Considerable universal service support is now being utilized to maintain telecommunications service rates in some areas of states at rate levels that are much lower than those existing for equivalent service in other areas of such states. To lessen this demand, Congress should provide for rate rebalancing.

Telephone rates have for decades been based in many instances on political and social considerations that could be justified and effective in a non-competitive, monopoly environment. Conversely, a competitive environment, where all telecommunications products and services are legally open to competition, should require state regulators to adjust these rates in a manner that reflects this new competitive marketplace reality. This rate rebalancing should be accomplished without the necessity of extensive and expensive rate cases. When accomplished on a revenue neutral basis, the remedy should not require extensive regulatory intervention.

Congress Should Ensure that Support is Based on Actual Costs

Because of the ever increasing demand for Universal Service Funds due to the requirement to fund multiple ETCs from a declining interstate revenue base, for larger ILECs, the FCC has employed a cost recovery methodology that does not permit the recovery of the actual costs incurred by such carriers in high cost areas. Universal service support is needed in high cost areas to keep telephone rates comparable to rates in other parts of the country and thus, widely affordable. Consequently, actual cost recovery is a necessary component of any universal service reform plan.

Congress Should Address How a New Uniform Intercarrier Compensation Plan Will Impact Universal Service

The necessary transition from the current intercarrier compensation system, including interstate and intrastate access charges, to a uniform intercarrier compensation plan under which carriers would recover their costs from end user or universal service, will have the potential to increase the demand for Universal Service Funding. This funding will be necessary to maintain reasonably comparable and affordable composite end user rates in high cost study areas and to allow continued network investment.

CONCLUSION

Congress should insist that our universal service support structure returns to the core concepts that were in place prior to the passage of the 1996 Act, but in a manner consistent with today's converged marketplace. Congress should ensure that everyone pays into the Fund on technology neutral principles; eligibility for ETC status should be based on sound economic and public interest fundamentals; support should be based on actual costs; states should not continue to expect that designation of additional ETCs is a license to increase the burden on interstate ratepayers; and, rationalizing the system of support cannot happen if rate rebalancing does not occur. Under these concepts, incumbent LECs and their customers will have a more equitable climate, while interexchange carriers will receive significant relief as a result of continued declines in the access charge regime. The funding burden can be relieved on everyone as the base of who contributes is broadened. This will promote investment in rural areas because there will be a reliable source of Universal Service Funding that keeps rates affordable, that gets comparable services out to these parts of the country, that encourages providers to invest in facilities and provide advanced services and intrastate calling should be much cheaper and providers will have more opportunity to creatively bundle their services.

Senator BURNS. Thank you, Mr. Dosch. We appreciate your testimony.

And now we will move to Mr. Gillis, who is Director, Center to Bridge the Digital Divide, Washington State University at Pullman, Washington. Thank you for coming today.

**STATEMENT OF DR. WILLIAM R. GILLIS, DIRECTOR,
WSU CENTER TO BRIDGE THE DIGITAL DIVIDE**

Dr. GILLIS. Thank you, Mr. Chairman. And this is very much a personal issue for me. I do not often brag about this, but I graduated in the top ten of my class, but there's only 12 in my whole high school class.

[Laughter.]

Dr. GILLIS. I am one of these rural boys, too.

[Laughter.]

Dr. GILLIS. And I really do believe—and I am concerned for my hometown and my family and friends largely because there seems to be a breakdown in the hearing rooms. I am a past State commissioner, and the hearing room breakdown comes over a conflict between competition and universal service, those that say one should take priority over another, and I firmly believe, for the benefit of my friends and family, that I want to see both competition and I want to see my friends and family have access to the best that American telecommunication has to offer. And I think congressional leadership is needed at this time to make sure we move forward with both those goals, and that is primarily what I want to talk to you about today.

And to set the context a bit, in 1996 when the Act was written, a lot of these things, like wireless and broad access to the Internet were just emerging. Really, the goal of universal service at that

time was to give everybody access to a telephone, you know, a good connection. But today what has happened is that my cousins in Seattle, they have access to a wireless system that does not have holes in it, you get E-911, they have access to broadband, and they have access to a couple of choices of their basic dial tone. Why should it be less for my friends or family in my little town? And I think that should be a goal, an important goal, and that is where the context has changed.

It has a couple of implications. One is the one that has been mentioned by almost everybody, is that because of these changes, with the broadening and the change in technology, the current collection base just does not work anymore, and that needs to be a priority. Second, the whole notion of comparability changes. I would ask the question, Is it really fair to say comparability now is just connecting the telephone? To me, comparability means my cousins in Seattle have access to quality wireless services that do not have holes in them, connection to E-911, and access to broadband. So that changes the context.

As far as direct recommendations to you and of the Congress, one is to deal with broadening the base of the collection mechanisms. I think it needs to be a very high priority. I think, in the hearing rooms, that is distracting, because that just sets up this conflict in competition that universal service does not need to happen.

And I agree with the point that you made, Mr. Chairman, that maybe it is time to just move on. If authority is the issue, then grant the authority to broaden the base if that is what is needed.

Second, I would ask for your leadership in dealing with the tension between supported deployment of mobile wireless broadband communication and a manageable fund size. I think it can be done. And I think one of the key things to make that happen through your leadership is that clearly Congress state its principles that, "Is it true that you want to have both competition and universal service?" And if that is, indeed, your intention, make that very clear to the parties.

And third, in my view, it would be worthwhile for Congress to encourage the FCC to set up a stakeholder process to deal with this issue of multiple ETC designations, particularly as it involves multiple wireless, and I understand the Joint Board is considering this issue at this time, and I do not mean to suggest to replace that process, but potentially to supplement that process.

There are a lot of very important issues that are out there that need to be dealt with, such as what network service standards are needed to fulfill the Act's requirement in providing reasonable and comparable services within all regions of the Nation, should there be standardized review standards for States and Federal agencies to follow, should eligible competing carriers continue to receive support on all lines, and so forth.

But I had the privilege of serving on the Rural Task Force with a couple of your panelists today, Joel Lubin and Jack Rhyner being among them. And this group, a very diverse group, came up with a consensus recommendation; and those of you who know Joel Lubin and Jack Rhyner, that has to give you hope, because, I mean, these are very diverse opinions, but they are able to work together and to come up with some recommendations that are mov-

ing things forward. And I think that would be an action that you ought to very seriously consider, to encourage that kind of stakeholder group to get together again and address this critical issue that is part of the meltdown we are seeing in the hearing room of multiple ETC designation in areas served by rural carriers, particularly as it affects mobile wireless, and I personally think there are solutions.

So I would just summarize with three specific recommendations of action to you. First of all, clarify the FCC authority to collect Federal universal service on the broadest possible base of telecommunications services, whatever that requires. I think that should be done as soon as possible. Second, provide a clear statement of principle regarding Congress' intent with respect to accomplishing both universal service and competition. That is your choice, but it would certainly be my hope that you would want to accomplish both equally. And third, encourage the FCC to undertake a broad stakeholder process focused on rethinking the current Federal rules for allocating universal service dollars to support mobile wireless and the competing provision of services in rural locations.

Again, these are threshold issues causing conflict. They are also creating uncertainty for investors, both incumbents and competitors, that would invest in my hometown and hometowns in your State, Mr. Chairman, and other rural places, and that is why I am here today, and thank you for the invitation.

[The prepared statement of Dr. Gillis follows:]

PREPARED STATEMENT OF DR. WILLIAM R. GILLIS, DIRECTOR,
WSU CENTER TO BRIDGE THE DIGITAL DIVIDE

My name is Bill Gillis. I serve as Director of the Center to Bridge the Digital Divide at Washington State University.¹ Between 1994 and 2000, I was a member of the Washington State Public Utility Commission. I have substantial experience in regulatory public policy matters impacting the availability and use of telecommunications and information systems in rural locations. For example, between 1997 and 2000, I chaired, on behalf of the Federal-State Joint Board on Universal Service, a Rural Task Force providing recommendations on appropriate reforms of the Federal universal service methodology supporting national universal service goals as required by the Telecommunications Act of 1996.

While my interest in accepting the invitation to appear as a part of today's panel is supported by my specific professional responsibilities and expertise, I am motivated also by my own roots in rural America.

The vast majority of the Nation's population resides in large urban centers. However, we remain a nation of small towns. Of the approximately 220 incorporated cities in the State of Washington, 180 have a population smaller than 5,000. Demographic and economic indicators document that many of these small cities and towns, once vital centers of commerce and activity, now struggle to sustain the most basic of community functions including viable income opportunities, local education, health care, civic participation, public facilities and governance.

I myself am a product of one of these smaller eastern Washington communities. My hometown is one of several in the State of Washington that are presently considering "dis-incorporating." In effect, throwing in the towel and closing the town's doors.

I am appreciative to this Committee for holding today's hearing. Six years after passage of the 1996 Telecommunications Act, I have an uneasy sense that resolve to implement the twin responsibilities of both competition and universal service as equal responsibilities under the 1996 Act is waning. Rural communities such as my

¹The comments provided in this testimony are mine alone and do not necessarily represent the views of Washington State University or any financial sponsor of the WSU Center to Bridge the Digital Divide.

hometown depend on access to the best telecommunications infrastructure and services available if they are to survive as communities and contribute to the economic and social strength of our Nation. My neighbors can ill afford to have progress in deploying necessary telecommunications investment sidetracked by needless conflict over whether regulatory or public policy should favor competition or universal service. The answer in my view is plainly outlined within the law that we are to accomplish *BOTH* of these essential goals.

There are some who will suggest to you that competition and universal service are fundamentally inconsistent in many rural areas and we must make a choice. Frequent are assertions that universal service can only be accomplished concurrently with competition in rural America at a very high cost. I disagree. I believe there are solutions that will enable us to preserve and advance universal service in rural America without abandoning the opportunity to make continued progress towards offering a greater number of our citizens a choice of alternative providers and services. Neither do I agree that this must necessarily result in an unacceptable expansion to the size of the national fund. Fundamental however, is a renewed commitment among regulators and the diverse stakeholders in rural America to focus on universal service and competition as goals that must be accomplished jointly—not simply balanced as necessary trade-offs.

My hope is that today's hearing will provide a sense of urgency from Congress that there must remain a national commitment to both universal service and competition as fundamental principles of the 1996 Act. Your leadership and directive to regulators and stakeholders in the debate, in my view, is essential to keep us on task.

Before turning specifically to the specific opportunities for Congressional leadership, I would like to highlight the significant industry changes since the passage of the 1996 Act and the implications for achieving national universal service goals.

The most notable change since 1996 is the explosion of both consumer demand and the availability of mobile wireless and Internet technologies. At the time of the passage of the 1996 Act, the primary universal service challenge was to ensure that the vast majority of Americans have access to a quality dial-tone voice telephone connection.

What a difference 6 years makes. In today's world the majority of Americans have access to a variety of telecommunications services including mobile wireless options, broadband connectivity and in more limited cases, a choice of basic dial tone providers.

While we should celebrate our successes in this regard, our purpose here today is to focus on the reality that there remain many Americans who currently do not enjoy access to a network providing the full benefits of modern telecommunications technologies.

In today's world it is no longer appropriate to consider the universal service challenge as simply connecting rural Americans to quality and affordable basic dial-tone. However, a narrow universal service focus on raising the standard to ensuring all Americans have access to the benefit of modern broadband Internet connectivity also is not responsive to the challenge before us.

What is required to fulfill the principles outlined by Section 254(b) of the Federal Telecommunications Act is that all regions of the Nation have access to a bundle of modern telecommunications services and options "reasonably comparable" to what is available in much of urban America and a growing number of rural locations, including where feasible, a choice of alternative service providers. Here lies the challenge that I believe is not widely articulated in regulatory hearing rooms.

We need to fundamentally rethink our approach to universal service in the modern era to accommodate the need to provide rural Americans with access to all the benefits of modern telecommunications including a network capable of accessing broadband services, mobile wireless and basic voice telephone. We, of course, need to do this responsibly without unnecessarily exploding the size of the Nation's Universal Service Fund. I believe this is entirely feasible, but we must first frame the problem correctly.

With this context in mind, I suggest there are two areas of Federal universal service policy for which Congressional attention is most critical at this time:

- (1) Congress should clarify FCC authority to collect Federal universal service on the broadest possible base of telecommunications services.
- (2) Congressional leadership is needed to address the current tension between supported deployment of mobile wireless, broadband connectivity and manageable fund size.

Congress Should Clarify FCC Authority to Collect Federal Universal Service on the Broadest Possible Base of Telecommunications Services

Section 254(d) of the 1996 Act establishes an obligation that “every telecommunications carrier that provides interstate telecommunications services shall contribute on an equitable and nondiscriminatory basis, to the specific, predictable and sufficient mechanisms established by the Commission to preserve and advance universal service.” The 1996 Act expressly sets a standard of adequacy for the Federal universal support program in that the support “should be explicit and sufficient to achieve the purposes of this section.” Sufficiency of support must be gauged against the standards embodied in the universal service principles set forth in Section 254(b).

It is my view that the current Federal universal service mechanism established by the FCC is broke and can not be relied upon to achieve the fundamental universal service obligations under the Act. To restore stability to the national high-cost universal service program, more fundamental reforms of the Federal collection mechanism are needed than the current tweaks to the existing mechanism.

While the FCC took positive steps forward to increase universal contribution from the growing number of wireless customers, the mechanism still heavily emphasizes collection from a declining base of traditional interstate and international long distance minutes of use. In addition to evidence of rapid customer substitution of national wireless plans for traditional inter-exchange carrier provided long-distance service, a look at the near future suggests a further migration of telecommunications traffic towards the Internet.

Shifts of customer usage such as these in response to new technological developments should be applauded and supported by public policy. These are precisely the types of changes we want from a dynamic telecommunications economy necessary to keep us among the leaders in the world. Unfortunately, the current collection mechanism is a distraction as it results in these necessary market transitions undermining the fiscal stability of the national Universal Service Fund.

This combination of events plays out in the Commission hearing room with polar positions being presented by the different interests, particularly those focused on expanding competitive options versus those concerned about the provision of quality and comparable telecommunications service in high cost rural areas.

It is time to move on and end the unnecessary drag on further regulatory policy reforms needed to encourage access to multiple telecommunications options for all Americans, both in rural and urban regions. Fundamental change to the current Federal collection mechanism is needed to ensure that advances in a dynamic telecommunications market do not undermine fundamental high-cost universal service principles.

Among the barriers to the joint advancement of both competitive options and universal service in rural America, is a lack of legal clarity regarding the extent the current base of services, upon which Federal universal service is collected, can be expanded. I believe it is important for Congress to find an appropriate vehicle to clarify your intent and it would be my hope that your intent would be to collect universal service from the broadest base of telecommunications customers possible. If it is determined that Congress must act with legislation to provide the FCC with additional authority to broaden the Federal universal service collection base, I believe it is important for you to act quickly and decisively in providing that authority.

Congressional Leadership is Needed to Address The Current Tension Between Supported Deployment of Mobile Wireless, Broadband Connectivity and Manageable Fund Size

One of the greatest barriers to progress in establishing a regulatory and public policy environment supportive of needed rural telecommunications investment by *BOTH* traditional and competing carriers is litigious conflict common both in Commission hearing rooms and other judicial forums. Uncertainty is the silent cancer of rural investment. The common polar positioning of competition and universal service and the resulting conflict among rural stakeholders is perhaps one of the greatest contributors to regulatory and ultimately investor uncertainty.

I believe Congress can play an important role in lessening this unproductive controversy if it is indeed your intent that both competitive choice and the deployment of a network providing access to the full benefits by all Americans to the benefits of modern telecommunications be achieved. While I would hope that this indeed is your intent, even if not, a formal clarification from Congress would help us all to move forward and end unproductive debate.

There are some, perhaps many, who may suggest my optimism that it is possible to advance both universal service and competitive choices without an unacceptable expansion of the national Universal Service Fund is naïve. The “devil is in the de-

tails” it will be pointed out and while the principle is sound, how is the principle achieved in practice?

I respond here rhetorically to this criticism with an obvious observation. In our democratic society, Congress, with the concurrence of the President, is responsible for establishing the formal legal framework for the implementation of national public policy. The delegated administrative authorities and those of us who participate in their formal and informal processes must act within that direction. If we do not frame the challenge properly in the context of Congress’ intent, then we will not get to the desired end game.

The current conflict found in regulatory hearing rooms suggests substantial disagreement among stakeholders regarding what was intended regarding our responsibility in advancing universal service and competition, with various suggestions of which of those two goals should have priority for rural America. I appear here today to suggest that clarification from Congress on what specifically you do expect may go a long ways towards focusing the implementers on the appropriate challenge and minimize distracting and unnecessary debate.

The challenge is illustrated by a tension in regulatory forums over a perceived conflict between deployment of mobile wireless technologies, broadband connectivity and maintaining the national Universal Service Fund at an acceptable level. When cast in the context of universal service and mobile wireless competition as being opposing goals for rural areas, no apparent solution to this tension is apparent.

However, by reframing the challenge as ensuring rural Americans have reasonably comparable access to a range of telecommunications services including quality mobile wireless, broadband connections and voice grade telephone without expanding the national Universal Service Fund beyond an acceptable level, solutions may be possible.

At the heart of the problem are current FCC rules that award Federal universal service on the basis of “eligible lines” provided by eligible carriers. In the case of mobile wireless carriers this means that when awarded status as an eligible telecommunications carrier, the mobile wireless carrier receives payment based on the number of connections to the network. In the case of mobile technologies, those connections are expanding at a rapid rate putting substantial pressure on the cost of Federal universal service.

Some interests will accurately point out that the typical mobile wireless technology does not provide access to the modern broadband network. It is extended from this observation that we may need to make a clear choice between substantially expanding the Fund to support mobile wireless and new investment by rural carriers with technology capable of a network of providing access to broadband services.

I would suggest reframing the issue in a different context. First, I would observe mobile wireless and traditional telecommunications are not for the most part competing services and have been inappropriately characterized as such. With the exception of those cases where mobile wireless has resulted in the ability of customers to eliminate their traditional telecommunications connection, we are discussing complementary services, both desired by consumers for different reasons.

A reasonable interpretation of the principles of Section 254(b) of the 1996 Act is that all regions of the Nation should have access to a quality mobile wireless network without coverage holes, access to 911 and quality connections. In addition, the standard of “reasonably comparable” service could (and in my view should) include supporting a rural network capable of providing access to broadband services, typically associated with wireline technology but also potentially fixed wireless solutions.

The public policy question is whether it is the desire of Congress that Federal universal service should support multiple technologies offering a broader functionality of service to consumers as well as competing providers in rural areas. If the answer to this question is yes, then the issue of impact on the size of the Fund becomes key. However, when properly framing the issue, the impact of funding multiple and potentially competing technologies in rural America should not be restricted by current application of Federal rules for allocating universal service support.

I suggest we should refocus the question as, “What would it cost and how do we appropriately allocate available universal service support to ensure rural Americans will have a choice to purchase both quality mobile wireless service and a service *CAPABLE* of providing broadband connectivity?” The question should not be answered in the context of applying current FCC rules which allocate universal service to mobile wireless carriers determined by state commissions as eligible to receive universal service. Rather the focus should be on how we should support comparable services in all regions of the Nation including multiple consumer options with the minimum impact on the size of the national Universal Service Fund.

Towards this end, I recommend Congress encourage the FCC to undertake a broad stakeholder process focused on rethinking the current Federal rules for allocating universal service dollars to support mobile wireless and the competing provision of services in rural locations. The question may appropriately be parsed out differently with regard to the mobile wireless question than the question of appropriate rules for allocating support to “competing” providers of service.

In the case of mobile wireless, careful attention should be given to whether the present practice of allocating universal service to carriers based upon the number of connections to the network makes sense. Focusing on the goal of eliminating current holes in the wireless network and dependable E-911 service in all locations, a distribution based on the number of cell phones supported by the carrier may not be appropriate. The costs incurred in meeting the objective are the construction new towers and the electronic enhancements. The current allocation system does not recognize the likely reality that adding new cell phone users only adds marginally to the cost of achieving the goal. An alternative basis of allocating subsidy supporting desired mobile wireless facility upgrades such as targeted grants or low-interest loans may be a more appropriate vehicle to achieve the desired end than the current practice of awarding universal service to wireless carriers on a per connection basis creating a potentially unnecessary expansion to the Federal fund. Other carefully targeted universal service options may also be possible.

In the case of truly competitive services, whether they be wireline or wireless, the FCC should consider rethinking a universal service portability recommendation originally put forward by the Rural Task Force that Universal Service Funds be awarded to eligible competing carriers only for those lines that are actually captured from the incumbent provider, *AND* the amount of money available to all providers in a given area be frozen at the level available when competition emerged with growth in funding tied to inflation and the number of new lines in that area.

The FCC’s decision was to reject the Rural Task Force’s recommendation on appropriate rules for dividing available Universal Service Funding between the traditional and competing carriers in areas served by rural telephone companies. Rather they chose to continue the practice of awarding competing carriers, including mobile wireless, a universal service allocation based on the total number of connections to the network. They further decided that the Fund would be allowed to grow to accommodate the needs of these competing providers.

Choosing to reject the Rural Task’s Force recommendation has had unfortunate consequences which are playing out today. For example, several parties assert that state public utility commissions have not been rigorously considering the public interest ramifications of allowing Federal Universal Service Funds to be used for competitive provision of services in rural areas. While there are certainly differences in process among states, for the most part I agree with this observation. However, it is not surprising given the current Federal rules. From a state perspective there is little potential of harm and there is an opportunity to gain as the amount of money available to the traditional rural carriers is not restricted by a decision to allow competition. The result is more Federal-sourced money flowing into states, but significant pressures on the Federal Universal Service Fund without any clear connection to the achievement of universal service goals.

Concluding Remarks

I very much appreciate your invitation today. We are needlessly losing ground in progress towards implementing the progressive vision of the 1996 Act over an unmerited controversy over asserted conflicting goals of universal service and competition.

At the same time, I remain optimistic that we can be successful in providing all Americans with access to the full benefits of the Nation’s telecommunications system including mobile wireless, broadband connectivity, and quality voice grade connections including in many cases a choice of alternative providers. I further believe this can be accomplished without an unacceptable expansion to the national Universal Service Fund.

I respectfully offer the following specific recommendations to advance both universal service and competition in rural America and provide for the stability and sufficiency of the Fund:

- Clarify FCC authority to collect Federal universal service on the broadest possible base of telecommunications services.
- Provide a clear statement of principle regarding Congress’ intent with respect to the accomplishment of BOTH universal service and competition.
- Encourage the FCC to undertake a broad stakeholder process focused on rethinking the current Federal rules for allocating universal service dollars to

support mobile wireless and the competing provision of services in rural locations.

Senator BURNS. You are a native of Washington, the State of Washington?

Dr. GILLIS. Yes, sir.

Senator BURNS. Where?

Dr. GILLIS. The town of Washtucna, Washington.

Senator BURNS. I know about where it is.

Mr. Hughes, thank you for coming today with Telepax. And Senator Lott has expressed his regrets he cannot be here today. He looked forward to hearing your testimony. Well, I guess we have several other things going on. I do not know what they would be, but the papers are full of them.

So we look forward to your testimony. Thank you for coming today.

STATEMENT OF CARSON HUGHES, CEO, TELAPEX, INC.

Mr. HUGHES. Thank you, Mr. Chairman and members of the Subcommittee.

I am Carson Hughes, and I am the CEO of Telapex, Inc. We own Cellular South. I appear on behalf of the Wireless Independent Group, or WIG, a coalition of four wireless providers currently providing wireless service mainly in rural areas in communities in 19 States across our Nation.

I am here to thank the Congress and the FCC for including the wireless companies in the USF program and to reassure you that your trust and that the people's money have been well placed for the benefit of the consumers living and traveling in the rural parts of our great Nation. I, in particular, want each of you to know that the USF moneys going to Cellular South are greatly benefiting our rural areas with construction for delivery of facility-based services.

Cellular South exists today because of two very rural wireline telephone companies with 40 years experience in rural Mississippi. The Cellular South ETC area is the vast majority of Mississippi for which Bell South is the ILEC. This largely rural area roughly equates in size to the State of Indiana.

Both the President of Cellular South and I were born and grew up in the rural Mississippi Delta. Our Mississippi owned and operated company maintains its customer-service operations in a very rural area in our State. We know and we love the rural areas we serve, and we know firsthand the advantages that good communications services can bring to such areas.

In the rural areas of our State, we have been hampered when competing with the ILEC by, among other things and other factors, first, the lack of Cellular South having sufficient infrastructure to provide dependable service at all points in time, and, second, the lack of a delivery system which would allow rates closer to those offered by the ILEC. The \$18.5 million received from USF funding in 2002, when combined with our own funds, allowed us to expend over \$33 million in and for the high-cost areas and, among other things, allowed us to greatly improve our coverage in the rural high-cost area with 34 new cell sites and to install a state-of-the-art CDMA 1X system in at least 169 cell sites and in our switching center. As a direct result—as a direct result—we can and do now

provide a \$49 a month unlimited service offering which allows local calls to all points in Mississippi and Memphis. By way of example, it is approximately 430 miles from Gulfport, Mississippi, to South Haven, Mississippi, not a bad unlimited calling area.

We thank you, we thank the Congress for allowing our people to have this service by allowing us to have USF funding. Because you have allowed us to have the USF funding, qualified low-income customers now have a choice of Lifeline service providers. Your allowing USF funding to be used by us has greatly improved the availability of 911 and similar services in our rural areas.

If the John Deere tractor company built your work desk, the work desk you drive to the field every day, it is hard to have a desk phone installed unless wireless coverage is available. Think about what this means in terms of safety and convenience to rural users. With your help—with your help—we will turn on at least 48 more cell sites in high-cost areas in 2003, continue to improve our infrastructure, continue expanding capacity and efficiency of the network with expenditures in excess of \$21 million in our high-cost areas.

We firmly believe and have shown by our efforts that high-cost support to wireless providers advances the cause of universal service, drives critical infrastructure in the rural areas, increases the availability of important 911 services at the point of need, and will continue to contribute to the economic development of rural areas.

Use of USF funds by a wireless company provides benefits to rural consumers far in excess of the less than 3 percent of the USF funds such use represents. Our customers who pay into the high-cost fund should benefit from the Fund.

We urge the Congress to provide the FCC with clear direction that they are charged with upholding the Communication Act, as well as the court decisions interpreting it, and that the rules for qualifying for and drawing from the high-cost support mechanism be administered in a competitive neutral fashion in a pro-competitive manner.

I would request that my comments be made a part of the record, and I assume the written submitted comments would also be made a part of the record.

Senator BURNS. All, both of them.

Mr. HUGHES. Thank you for your indulgence and your courtesies extended.

[The prepared statement of Mr. Hughes follows:]

PREPARED STATEMENT OF CARSON HUGHES, CEO, TELAPEX, INC.

Mr. Chairman and members of the Subcommittee:

Thank you for this opportunity to testify on behalf of a coalition of independent wireless carriers called the Wireless Independent Group ("WIG"). Members of the coalition include Cellular South Licenses, Inc., Hargray Wireless, L.L.C., Midwest Wireless Communications L.L.C., and Rural Cellular Corporation. I am the Chief Executive Officer of Telapex, Inc., Cellular South's parent company.

WIG member companies serve people in communities in 19 states, including Alabama, Arkansas, Iowa, Georgia, Florida, Kansas, Maine, Massachusetts, Minnesota, Mississippi, New Hampshire, New York, Oregon, South Carolina, South Dakota, Tennessee, Vermont, Washington and Wisconsin. In each of these states, the vast majority of area served by WIG member companies is rural.

If you examine the operations, the composition and demographics of WIG members' service area, the challenges we face in rural areas, and our goals, you will like-

ly conclude that we have a great deal in common with incumbent local exchange carriers (“ILECs”) serving rural areas throughout the country. For example, Cellular South’s current ETC service area, which is also served by Bell South, roughly 38,000 square miles, larger than the state of Indiana. Most of it can fairly be described as sparsely populated and remote, with small towns scattered throughout. We are locally owned and operated. We live, work and play in the communities we serve and believe that investment in these communities is one of the best ways to differentiate ourselves from large national wireless carriers that we compete with.

Like all of you, WIG members are committed to the long-term sustainability of the universal service support system and have seen first hand how it helps the lives of those living in rural and underserved communities. As one of the few wireless companies that have actually received Universal Service Funds, we hope to provide you with our perspective on how high-cost funds are improving rural communities we serve.

For ease of reference, my testimony is divided into three sections. Section I describes our company and our experience in Mississippi as a competitive ETC (“CETC”). Section II outlines specific policy positions that Cellular South supports. Section III provides responses to some of the more popular arguments advanced by ILECs in presentations made to the FCC and Members of this Committee.

I. A Description of Cellular South and Our Experience as a Competitive ETC

A. Our Company

Cellular South (or its predecessor) has been licensed to provide mobile wireless service in rural Mississippi since 1988. Our company philosophy is to provide our customers with the highest quality voice service and to differentiate our product from other wireless carriers by providing superior network quality and customer service. We believe we provide the highest quality service of any wireless company in our state and that our CDMA 1X network in rural areas is superior to our wireless competition. Our customer quality surveys, our churn rate, and our interaction with customers tell us that we have developed a first rate wireless system serving many rural areas in Mississippi.

Since our inception, we have not been able to compete as effectively as we would like with Bell South for local exchange customers simply because our network is not robust enough to deliver in all rural areas the service quality that persons living in urban areas such as our state capital, Jackson, have come to enjoy.¹

Because Bell South was the only carrier receiving high-cost support in much of rural Mississippi, it was very difficult for any carrier using any technology to achieve network and service quality at price points low enough to be competitive. In the 1996 Telecom Act, Congress directed the FCC to designate additional ETCs throughout the country. Since 1997, the FCC has released a series of rulemaking orders implementing the 1996 Act and designating CETCs.

In 2001, Cellular South applied for and received a grant of ETC status from the Mississippi Public Utility Commission for the area served by Bell South, which comprises over three quarters of the state and includes some of the most rural portions of Mississippi. In early 2002, we began receiving high cost support from the Federal fund. Today, we receive an average of approximately \$6.70 per month per line in high-cost support.

B. Our Experience

Federal law requires eligible carriers to use high-cost support solely to construct, improve, and maintain facilities and services in designated ETC areas. We have done just that and the results have been remarkable for Mississippi’s rural residents.

1. Network Improvements Have Provided Important Health and Safety Benefits

High-cost support has enabled Cellular South to significantly accelerate its planned upgrade to CDMA 1X digital technology in at least 169 cell sites and at our switching center which, (1) provides consumers with the highest quality voice service available, (2) contains significant additional features that customers want that are not available on our old analog or TDMA networks, (3) greatly increases the capacity of our system, enabling us to improve the quantity of service we can provide to customers, and (4) enables us to meet the FCC’s E-911 mandates more efficiently. We have also initiated service at 34 new cell sites in high-cost areas in

¹I note here that although the FCC officially classifies Bell South as a “nonrural” carrier, they nonetheless receive universal service support for their operations in Mississippi because of the rural character of our state.

2002, and plan to turn on at least 48 more in 2003. CDMA 1X is one of the most advanced digital standard and will enable us to deliver high-speed data services to our customers as demand for such services increases.

Most important, each new cell site provides to rural consumers the benefit of 911 service. Citizens in rural areas depend on mobile phones more and more to provide critical communications needs. Those in need may be on farms, on remote roads, in bad weather, or as we witnessed only a year ago in Arizona, in firestorms, far from where assistance can be summoned by more traditional means, or separated from family or home for long periods.

E-911, which permits a caller to be located and tracked, will be useless in areas where signal is weak or non-existent. It is self-evident that every time Cellular South adds a cell site or increases channel capacity, the number of completed 911 calls will increase. 911 and E-911 services are supported by Universal Service Funds. We can think of no more important benefit that can be conferred on rural consumers than providing reliable wireless infrastructure on a par with that enjoyed in urban areas.

2. High Cost Support Has Improved Consumer Choices

While generally speaking, the wireless service coverage gap between rural areas and urban areas continues to grow, high-cost funding in our rural areas is narrowing that gap. The business case for constructing quality wireless networks in rural areas is almost as difficult to make as the one for constructing a competing wireline network. Attempting to compete with long established incumbent wireline carriers in the local exchange market is extremely difficult, if not out of the question.

With high-cost support, a competitor such as Cellular South has an opportunity to deploy network facilities that enable service quality improvements that enable customers to see wireless as a viable alternative to local exchange telephony, while at the same time extending the benefits of universal service. Although it is too early to measure our progress with any precision, we believe that our CDMA 1X overlay and deployment of new cell sites in 2002 is having a significant impact on the competitive landscape in Mississippi, to the benefit of the citizens of our state. In addition, we believe that the deployment of approximately 48 new sites in 2003 will accelerate our ability to compete in rural areas.

For example, our upgraded CDMA 1X network permits us to offer customers a larger local calling area (all of Mississippi and Memphis) and a lower price. Larger local calling areas are a critical competitive factor—because most basic calling plans offered by wireline carriers offer very small local calling areas that provide toll free calling to only a few thousand, or sometimes only a few hundred, numbers. All other calls incur toll charges. Customers in many rural areas across the country pay much higher rates for in-state toll calls and most interexchange carriers do not offer their discounted interexchange toll service rate plans in many rural areas.

In contrast, we are able to offer customers the ability to make unlimited calls throughout the state, and include Memphis, for \$49.99 per month. For Cellular South to be competitive in rural areas, we need to deliver a robust and high quality network with both coverage and capacity. It is the provision of high-cost support that is enabling us to deliver competitive choices to rural consumers.

ETC status has also enabled us to commence offering Federal Lifeline and Link-Up benefits to eligible consumers. Lifeline and Link Up provide discounts on service and connection charges to consumers who participate in Federal low-income programs. We have advertised the availability of Lifeline and engaged in specific outreach efforts at local health, welfare, and employment offices, to inform consumers of the availability of these benefits. We have freestanding signs in our stores to promote Lifeline and Link-Up and have instituted specific training for all of our new sales representatives so prospective customers can be made aware of the benefits.

Even low income consumers in rural areas now have a choice of service provider. Eligible customers can obtain telephone service from us for as little as \$7.00 per month. This essential benefit for those most in need advances universal service and competitive choices to those most in need.

II. Policy Positions

A. High-Cost Support Advances Universal Service and Drives Critical Infrastructure Development in Rural Areas.

In urban areas, it is taken for granted that in most areas you can complete a wireless call in an emergency. In a very short time, consumer expectations for wireless have risen enormously, to the point where the failure to complete an important health or safety call is newsworthy. In many rural areas served by WIG members, expectations are often very different. Consumers understand that wireless phones

work in larger towns and on major roads, and not much beyond that. Unlike urban dwellers, many rural Mississippians have traditionally seen mobile phones more as ancillary communications tools, rather than one that can be counted on to provide primary telephone service.

While the national press has recently focused on the benefits of E-911 service and the need to accelerate its deployment, WIG members believe the best thing Congress and the FCC can do for rural America is to ensure that critical infrastructure is developed to permit callers to complete 911 calls. Without a cell site, there is no 911 service. E-911 system upgrades a carrier can invest in to locate a 911 caller will not help someone who cannot complete the call.

The FCC's rules require all support to be used for the construction, provision and maintenance of facilities and services within the designated ETC support area. For us, there is no more important goal than to improve coverage within our existing service area. High-cost support has provided us with an opportunity to achieve that goal. Since obtaining ETC status, we have committed to an infrastructure development plan that significantly exceeds the amount we are receiving from the Fund.

With respect to universal service, we can think of few achievable goals more important than driving investment into rural areas that will improve critical infrastructure. At Cellular South, our new cell site construction is rapidly filling in service gaps and extending our reach in rural areas that we would not have reached for many years, if ever. In addition, it is self-evident that the number of important health and safety calls, such as those made by doctors, volunteer firemen, police, and first responders, is increasing with every new cell site that we construct in rural areas.

For all of these reasons, we urge Congress to ensure that high-cost funds continue to be available to wireless carriers.

B. High-Cost Support Will Bring Economic Development to Rural Areas.

As a rule, our Nation's rural areas have long trailed cities in terms of economic development. Use of high-cost support to improve infrastructure has significant economic impact on small communities and is a key to closing that gap. Today, many companies and people consider rural areas as more attractive places to locate and to live. One of the major factors involved in selecting a community is the quality of its telecommunications infrastructure.

Wireless service is a very important factor in the equation. In our experience, more and more companies and people today rely on wireless phones to improve efficiencies and manage their businesses, especially in rural areas where the distances between job sites can be large, and in the case of farms and ranches, the job site itself can be quite large.

At Cellular South, we believe that a number of small communities where we have constructed new cell sites are now better positioned to attract and keep business. We urge the Congress and the FCC to recognize the substantial economic benefits that can accrue to rural America as a result of the provision of high-cost support to wireless carriers.

C. Wireless Carriers Pay Into the Fund And Are Entitled To Draw From It.

For years now, wireless subscribers have been required to contribute to the Universal Service Fund, to support wireline service. Yet ILECs have generally and vigorously opposed wireless companies' efforts to gain ETC status in rural areas, even though under the current system they are not harmed as a result of a competitor's designation.

Just this year, the FCC nearly doubled the amount that wireless subscribers must pay into the Universal Service Fund. It is completely unfair for wireless subscribers to contribute to a fund without having a fair opportunity to receive the benefits that both the Congress and the FCC have long ago determined are to be made available to competitors.

Over the past seven years, the FCC has implemented a comprehensive plan to carry out Congress' mandate to provide high-cost support to competitors in rural areas. Virtually every state has followed suit, adopting rules and deciding cases to designate new competitors. Still, long after being discredited at the FCC and in the courts, many ILECs still view the high-cost fund as theirs alone. They see landline telephone service as the only "true" universal service, which in areas where wireless service is available, is no longer the case.

We, like other WIG members, have played by the rules to apply for and obtain support, often enduring a process that is far more protracted and expensive than is necessary, opposed by well financed incumbents backed by national organizations. Wireless carriers are capable of advancing Congress' twin goals of promoting universal service and competition in rural areas, if given the opportunity. In all fair-

ness, if wireless subscribers are required to pay into the Fund and support wireline networks, they must be permitted to obtain the benefits that the universal service system was designed to provide.

D. Congress Should Ensure That the FCC Continues To Enforce The 1996 Act and Administer All Federal ETC Rules In a Competitively Neutral Manner.

Following Congressional direction contained in Section 254(h)(2) of the Act, the FCC adopted competitive neutrality as a core principle for its universal service program, stating, “competitive neutrality means that universal service support mechanisms and rules neither unfairly advantage nor disadvantage one provider over another, and neither unfairly favor nor disfavor one technology over another.” Federal-State Joint Board On Universal Service (Report and Order), 12 FCC Rcd 8776 (1997) at paras. 47–49.

In spite of this principle, ILECs have steadfastly urged states to adopt eligibility criteria and rules for CETCs that are not competitively neutral. In many cases, they have succeeded in turning the ETC designation process into an extended litigation that is far more arduous than even obtaining a certificate to become an ILEC. Seven years after the 1996 Act, only a trickle of CETC designations have been made. ILEC opposition at the state level has greatly contributed to this long delay.

The standard set forth by Congress and the FCC is relatively simple. In rural areas, a state is required to examine whether a petitioner will advertise and provide the nine supported services and that a grant will serve the public interest. Some ILECs now urge that the public interest bar be raised, suggesting a long list of eligibility requirements that were never imposed on ILECs.

We believe that Congress gave clear direction here and if it wanted a lengthy list of eligibility criteria, it would have specified them in the Act or directed the FCC to do so. It is not competitively neutral to make ETC designations easy for ILECs and difficult for others.

With respect to ongoing regulation of CETCs, Congress preserved the state preemption of rates and entry for CMRS carriers, even when a CMRS carrier seeks ETC designation. States are free to regulate “other terms and conditions” of service. Most states have properly understood this, however a few have attempted to impose tariffs and otherwise regulate rates that violate the preemption. Some CETCs have assented to such regulation as a condition of obtaining ETC status simply because it is expensive to litigate and delays in receiving funding mean delays in bringing competition to the marketplace.

Some ILECs have taken the position that it is competitively neutral to cause CETCs to be subject to the same regulatory structures as ILECs. Not true. Such ILECs ignore the fact that the purpose of ILEC regulatory structures is to protect consumers from monopoly abuse, which is simply not possible in a competitive market.

Asymmetrical regulation of a monopoly and its competitors is not only appropriate in the current case, it has been implemented before with success. For example, when AT&T was broken up in 1984, monopoly regulation continued to be applied to AT&T until such time as its monopoly grip was broken, after which such regulations were dismantled.

Cellular South is a prime example of why such regulations are unnecessary. We believe that we are already in substantial compliance with the state service quality regulations applicable to Bell South—and that has been accomplished without any special regulatory requirements being imposed on us. Like all carriers in a competitive market, Cellular South cannot afford to act like a monopoly because its customers have a choice of service provider. If a customer does not like our service, they may choose another wireless carrier, or the ILEC’s service. Most ILEC customers in rural America do not have the same choice and therefore regulation must take the place of a competitor.

E. Portability of Support is Essential to Promoting Competition and Universal Service.

When a CETC gets a customer, it receives the same amount of “per line” support as the ILEC receives for serving that customer. This is called portability of support. Portability is the lynchpin that levels the playing field among competitors. It is the ability to compete for customers on a level playing field that drives infrastructure investment and improves services for consumers in areas where monopoly service would otherwise be the norm for the foreseeable future.

Portability was a cornerstone of the FCC’s policy for providing high-cost support to CETCs and the concept was specifically affirmed by the 5th Circuit in the Alenco case:

The purpose of universal service is to benefit the customer, not the carrier. “Sufficient” funding of the customer’s right to adequate telephone service can be achieved regardless of which carrier ultimately receives the subsidy . . . What petitioners seek is not merely predictable funding mechanisms, but predictable market outcomes. Indeed, what they wish is protection from competition, the very antithesis of the Act.

The court also stated:

The Act does *not* guarantee all local telephone service providers a sufficient return on investment; quite the contrary, it is intended to introduce competition into the market. Competition necessarily brings the risk that some telephone service providers will be unable to compete. The Act only promises universal service, and that is a goal that requires sufficient funding of *customers*, not *providers*. So long as there is sufficient and competitively neutral funding to enable all customers to receive basic telecommunications services, the FCC has satisfied the Act and is not further required to ensure sufficient funding of every local telephone provider as well.

Alenco v. FCC, 201 F.3d 608 (5th Cir. 2000).

Put simply, portability of support is a core element of the FCC’s universal service high-cost support mechanism. Without portability of support, there is no hope of advancing universal service and bringing the benefits of competition to high-cost areas.

F. The High-Cost Fund is Not “Exploding” As a Result of CETC Designations.

For months ILEC lobbyists have proclaimed that the size of the high-cost fund is exploding as a result of ETC designations to competitive carriers. This is untrue. According to the Cellular Telecommunications and Internet Association (“CTIA”), over the past three years, high-cost support to CETCs increased by approximately \$175 million. During that same period, high-cost support to rural ILECs increased by approximately \$2.1 *billion*. It is my understanding that, in 2001, rural ILECs successfully lobbied the FCC to provide them with a major increase in high-cost funding through 2006. Prior to that, they sued the FCC in Federal court to remove caps on their funding and have consistently argued that the size of the Fund must not be considered when determining whether funding (to them) is sufficient.

In short, rural ILEC lobbyists now for the first time argue that a \$100 million increase in the size of the Fund to competitors threatens the Fund’s viability. There can be no doubt but that the increase in high-cost funds paid to carriers has increased almost exclusively as a result of increases to rural ILECs.

The fund is also increasing because the FCC has properly implemented its Congressional mandate to make all universal service support explicit—that is—to remove support from ILEC rates so that rates are cost-based and support is in plain view. As the FCC has removed support from rates and placed it in new high-cost programs, such as for example, Interstate Access Support, customers see on their bills exactly what they pay for service and what they pay for universal service support.

To be clear, as more support is moved out of ILEC rates and into explicit funding mechanisms, the Fund will continue to grow and rates will decline. This has been expected and is a good thing. It permits all participants to compete for customers and support on a more level playing field.

Finally, we note that most of the growth in the high-cost fund generally is within that the Schools and Libraries Program, which is a subset of the high-cost support program. We agree with suggestions that the Schools and Libraries Program should be severed from the high-cost fund, at least for the practical purpose of grouping together only those programs that have similar purposes. But make no mistake—in response to claims that the viability of the Fund is threatened, CETCs are not the responsible party.

G. Fund Growth Must be Managed in a Competitively Neutral Fashion.

It is self-evident that, as more CETCs are designated, the high-cost fund is going to grow. WIG supports careful management of the high-cost fund, provided that it is done in a competitively neutral fashion. An increase is only appropriate if consumers receive appropriate levels of support and if carriers are using support for the intended purposes. The high-cost fund is not a set aside program for incumbents, nor is it the duty of regulators to ensure a market outcome in favor of ILECs. Quite to the contrary, if the Fund is to be preserved and universal service advanced, then State and Federal Government should support efficient technologies and promote competition for support so that private industry has an incentive to drive infrastructure investment out to rural areas.

Competition for customers and support will drive costs down, and likewise, reduce the overall level of support required nationwide. In the meantime, an increase in the size of the Fund is not necessarily a negative if the increase is used to improve critical wireless infrastructure in rural areas that currently have substandard networks and lack reliable 911 service.

Managing growth of the Fund is a complicated task that is not susceptible to a quick fix. As the expert agency, the FCC must work within the statutory framework of the Communications Act to ensure that wireless companies, which pay into the Fund and currently receive less than 4 percent of the total high-cost support, have the same opportunity to obtain support in rural areas as do ILECs.

III. WIG Responses to Common ILEC Arguments

From the WIG perspective, Congress and the FCC set forth laws and rules implementing a system for encouraging competitors to obtain ETC status. I am advised that rural ILEC lobbyists have asked the FCC to reverse policies that have encouraged competition in rural areas. Thus far, they have succeeded in getting the FCC to initiate a proceeding to reexamine its policies for designating and distributing high-cost support to CETCs, without examining how the overall system for providing support to all carriers can be improved.

Here are our positions in response to a few of the more popular ILEC misstatements:

A. *The Universal Service System Should Not Support More Than One Network in Rural Areas.*

Many ILECs state, without any supporting economic evidence of which we are aware, that most rural areas will not support competition and therefore the government should not be supporting duplicative networks, risking stranded plant and endangering universal service. The common argument is that competitive carriers are going to construct five or six wireless networks in remote areas that will not today support even two competitors.

This argument directly contradicts Congress' express goal set forth in Section 254(b) of the Act that

Consumers in all regions of the Nation, including low-income consumers and those in rural, insular, and high cost areas, should have access to telecommunications and information services, including interexchange services and advanced telecommunications and information services, that are reasonably comparable to those services provided in urban areas and that are available at rates that are reasonably comparable to rates charged for similar services in urban areas.

The current system provides exactly the proper incentive for CETCs to enter rural areas. We are not aware of any evidence that any significant number of rural customers are going to abandon wireline service any time soon. We suggest that competitive market forces supply a very good discipline on market participants. The long-term economic benefits of competition represent the greatest potential gain for consumers in rural areas and for rural economic development. Those benefits cannot be realized if one carrier is funded to the exclusion of all others.

Reserving support for ILECs harms consumers in rural areas by relegating them to second class status indefinitely by locking out improvements in service and new services (such as mobile service) that can be introduced by competitors. We urge Congress and the FCC to reject these and other ILEC arguments that seek market outcomes in their favor, especially when such companies are asking the FCC to set aside of spectrum for the second time in 15 years, or to adopt eligibility rules favoring rural ILECs.

B. *High-Cost Support to CETCs Stimulates Artificial Competition.*

We believe exactly the opposite is true—that denying high-cost support to CETCs cements artificial monopolies into place. If no high-cost support were available to any carrier, most of the wireline infrastructure that is today in use in high-cost areas would not have been constructed. Unfortunately, that infrastructure has been constructed at a very high price. A system that only supports one carrier artificially keeps a monopoly in place and denies consumers the benefits that a competitive system inevitably and surely brings.

We believe that most every rural area in America can support competition, especially if competitors only receive support to the extent that they have a customer. Throughout the country, in over 30 cases, we are not aware that ILECs have been able to demonstrate any consumer harms which will arise as a result of competitive entry.

In northeast Arizona, one of the most remote and sparsely populated areas of the country, it is my understanding that a CETC has signed up over 25,000 new cus-

tomers on Native American lands in just 18 months since becoming an ETC. I am also advised that in rural northeastern Colorado, a new CETC has signed up over 500 new subscribers that have “cut the cord” with their ILEC in just one year, while using high-cost support to provide improved service and more choices to consumers.

As a general rule, we believe that consumers throughout this country should enjoy the benefits of competition.

C. CETCs Receive Support Based Upon ILEC Costs.

The FCC properly determined that high-cost support must be made available to all eligible carriers, no matter what technology is used. ILECs and CETCs receive high-cost support in completely different ways. ILECs use cost studies to obtain “explicit” support from the high-cost fund, and receive additional implicit high-cost support within their rate structure. A wireless CETC receives no implicit support and can only receive the “per line” support available to an ILEC when it gets a customer.

In order for a CETC to gain support, it must get and maintain customers. Therefore, it is misleading to say that a competitor is getting paid on ILEC costs.

Moreover, it is not by any means clear that a wireline carrier’s “per line” costs in remote areas are lower than those of wireless carriers. In fact, the opposite may be true because in most rural areas, wireless carriers have fewer customers. Their networks are relatively young and require much more capital expenditures to extend new service than do wireline networks, which are mature and not growing rapidly. From all we have observed, allegations that the current system provides excess support to wireless carriers are unfounded.

The current system, which forces market participants to compete for customers and support is the right approach. WIG believes that the size of the Fund must be managed in a competitively neutral fashion so that all carriers can compete for customers and for support on a relatively level playing field.

D. The High-Cost Support Mechanism Appropriately Funds All Lines

From the outset, the high-cost fund has supported all lines because the cost of providing all services are spread across an ILEC’s entire network, including primary lines, second lines, fax lines, lines in vacation homes, and lines dedicated to Internet access. Spreading costs across the entire network is appropriate because it enables an accurate determination of whether the costs of providing that network are above the level which triggers high-cost support.

Some have posited that the Fund should support only one line per household. Others advocate only one line per household per competitor. A few theorists believe that only the primary line in a household should receive support and that the customer should designate its primary line for purposes of high-cost support.

We view all of these approaches as band-aids that provide no comprehensive answer to the problem of fund growth. I am advised that we may agree with ILECs that these solutions will be arbitrary and unlikely to result in appropriate support levels being achieved. Moreover, a system where customers designate a primary line will undoubtedly lead to a new class of “slamming” caused by carriers competing over the “primary” designation. In the end, consumers are likely to be harmed.

All lines are properly funded under the current system, and if change is to be made, it should be done thoughtfully and carefully.

Concluding Remarks

WIG members and other wireless carriers have played by the rules in obtaining ETC status and are now beginning to deliver on the promise that Congress made to rural America. Certain rural ILECs seek to cut short the process by urging quick changes that favor only them in a regulatory area that is more complex than almost any other in telecommunications. The Federal-State Joint Board is currently requesting comment on well over 100 issues relating to the universal service system.

We urge thoughtful consideration by regulators, industry leaders and other experts. WIG believes that another process similar to that conducted by the Rural Task Force should be instituted to achieve useful and productive recommendations that encompass both CETCs and ILECs, so that comprehensive and competitively neutral solutions are reached. Piecemeal decisions advocated by some ILECs will be disruptive to rural subscribers, or worse yet, deny them the benefits of competition that they deserve.

We do not come here today with all the answers. What we do know is that making it harder for ETCs to be designated, imposing onerous monopoly-era regulations, and reducing support to competitors but not incumbents, all appear to be on the shopping list of certain ILECs. All are bad for rural consumers and we believe are contrary to Congressional and FCC directives that consumers be the focus of universal service policy decisions.

In our ETC service area, Bell South has both a monopoly on wireline facilities and in some areas, a 40 percent interest in a formidable wireless network, operating under the Cingular brand name. They have enormous capital resources, the highest credit rating, a national advertising budget, Section 271 authority to provide long distance services, and the ability to bundle wireline and wireless services to their existing and potential customers. Their market advantages are enormous. It is only the provision of high-cost support which begins to level the playing field, providing Cellular South an opportunity to construct a network that can challenge their lock on the market and more important, give rural Mississippi consumers the advantages of quality competitive wireless services enjoyed by their urban cousins. If they believe that we are capturing any significant market share, they can respond in the marketplace and I'm sure they will.

We urge Congress to provide the FCC with clear direction that they are charged with upholding the Communications Act, as well as Court decisions interpreting it—and that the rules for qualifying for and drawing from the high-cost support mechanism be administered in a competitively neutral fashion and in a pro-competitive manner.

Senator BURNS. Thank you, Mr. Hughes, for coming today, and we appreciate that very much.

And we have been joined by another one of them country boys, Senator Dorgan, from North Dakota. Senator Dorgan, did you have a statement? We have all just kind of put our statements in and we started the testimony early, and this panel has already testified and ready for questioning. So would you like to do both of them at the same time or one of each or—

Senator DORGAN. Well, Mr. Chairman, first of all, I thank you for your courtesy. As is probably the case with you, I have three different committee meetings at the same time, and so I was unable to be here at the start of this hearing. But I think you are right in holding a hearing on universal service, because I think whether it is Montana or North Dakota or other rural areas of the country, particularly the high-cost areas of the country, universal service is a really critical and an important issue.

If I might make just a comment, the issue of universal service is about comparable service at comparable prices. And we decided some long while ago, as a matter of public policy, that if you lived in a very small area—Grenora, North Dakota, with 60 or 80 citizens living there, or New York City—the availability of a phone in a big city is made more valuable by the availability of a phone in a small town. Donald Trump's phone in Trump Plaza, New York City, is more valuable because he can call somebody in Cut Bank, Montana. I do not know if he will want to.

[Laughter.]

Senator DORGAN. But the fact is, the presence of every telephone makes every other telephone more valuable. So if telephone service were not universal in nature, and the issue were just, "Well, whatever it costs, that is what it costs; we will not care about driving down high-cost areas so that there is universal opportunity to have telephones," we would not have truly a national system or a universal system by which everyone would have affordable service.

That is the basis of what universal service was when it was established. It also stands, for those of us who were involved in writing the 1996 Act, for the availability of advanced services, advanced telecommunications services—*i.e.*, broadband, *et cetera*.

But now what is happening with universal service is that the entire system, I think, is dramatically threatened, interstate revenues are plummeting and the program is under assault. And our job, I

think—while there are some issues we can wiggle around on, I think our job is try to figure out how do you have a robust, stable, broad funding base that makes the Universal Service Fund available for the long term, and supports driving down costs in high-cost areas and also especially supports the availability of advanced services in all areas, especially high-cost areas.

So those are the issues that we have, Mr. Chairman. As the Chairman knows, I come from a town of—I guess it is now 295 people. When I left—

Senator BURNS. Is it bigger than Grenora?

Senator DORGAN. It is bigger than Grenora. But when I left, my hometown was roughly 400 people, 380 to 400 people. It has now shrunk by about a third. But the analysis by the FCC at one point was that if you take a look at the fixed costs, to provide a system of telephone service in a town of 350 people was dramatically more expensive than to provide telephone service in an area where you can spread the fixed costs over far more customers. And so the result is universal service drives down high-cost areas so that everybody has affordable service.

I just say that by way of pointing out that we must, this year, find a way to intercept what is happening to the Universal Service Fund. Fewer people are making long-distance calls. They are less expensive when they do make them. More people are using the Internet, instant messaging, e-mails, and so on, and the fact is we are losing the base for this Universal Service Fund. That is why I think this hearing is a very important first step, Mr. Chairman, in recognizing that. And because you come from Montana, I think you are in a very important position. I am pleased to be a part of this effort to say that we cannot continue down this road. The Universal Service Fund will not succeed in the—I should say “the Fund” will not succeed in the long-term unless we do something to provide stable long-term funding for it.

So that is all I wanted to contribute today, and I appreciate the other issues that have been raised by people who have testified today. They are not inconsequential, but I must say that if we do not solve the longer-term funding issue, we will not have much of a fund to debate about. It will just be a minimum amount of money, and we can have a robust debate about nothing. But, you know, that is not very interesting to me.

So I hope, in the next 6 months or so, Mr. Chairman, you and I and others can engage in trying to figure out how we make a U-turn and instead of seeing a shrinking fund, find mechanisms by which we can provide resources to have that fund become the kind of fund it is supposed to be to drive down the costs in high-cost areas.

Thank you very much, Mr. Chairman.

Senator BURNS. Senator Dorgan, we had Commissioner Abernathy here from the Commission, and we were sort of critical of the Commission because they have not stepped up to the plate and made any recommendations that had any permanence to them. And whether it is going to take legislation to do this or not, I recommended that it is time that we start talking to the Universal Service Board and the FCC and Congress in some kind of a summit—it may take a half a day to walk through what has been done,

what has been recommended—and then sort out the situation that if it takes legislation, then we should be working on that right now. It should be done this year. We do not have a lot of time.

And I look forward to working with you, and maybe we can arrange that, to work together on this thing with those other two entities and maybe come to a sort of an agreement where we can pass legislation and work together on it.

Senator DORGAN. Well, Mr. Chairman, I would be happy to do that. This problem goes all the way back to the initial judgments by the Federal Communications Commission following the passage of the 1996 Act.

Senator BURNS. Yes.

Senator DORGAN. Misjudgments have been made consistently. In addition to the misjudgments, which latched us to a funding source that has diminished, in addition to that, the Commission, the FCC, I believe has some significant authority to remedy this, but it has been unwilling to move. So it is kind of, you know, you look like a potted plant in some of these areas, just sort of sitting around waiting for things to happen, and nothing will happen, and you just have this diminished pot of funds for universal service. But I think that is a great idea, and I look forward to working with you.

Senator BURNS. Well, I like your illustration of a potted plant. That means a lot to you.

[Laughter.]

Senator BURNS. The other day at a committee hearing, you brought a plant of leafy spurge to Interior. Everybody is dying now to get leafy spurge started in their yard. Did you know that? The new flower of Washington, D.C.

Senator DORGAN. Well, I can help. Just one plant will have a yard full in a couple of months.

[Laughter.]

Senator BURNS. I want to continue along with the questioning now, and I appreciate the testimony of Mr. Lubin and the recommendations that he has.

Mr. Lubin, how do you view the concept of the wireless safe harbor permitted under the FCC rules? Is this approach fair? And does it run the risk of basically destabilizing the Fund?

Mr. LUBIN. Thank you for the question. AT&T is very concerned about the safe harbor concept. It is concerned about the safe harbor concept for two reasons. The first, by putting a ceiling of 28.5 percent on what percentage of the revenue would be attributable to interstate, puts a cap. So if I have a customer who is making 200 minutes of interstate calling and who is being charged, say, 5 cents a minute, they are paying \$10 of long distance.

Unfortunately, what I have on my bill, as of April 1, yesterday, is 9.1 percent. So, all of a sudden, if that customer sees 9.1 percent on my traffic and decides to move to a wireless, it is capped at 28.5. So that is one issue, in terms of they were getting 9.1 percent on that revenue from that customer. All of the sudden it goes to the wireless vendor, who is capped at 28.5, and there are no incremental USF contributions flowing in.

But there is a second issue, and the second issue is, What does the customer see on their bill? On my bill, they see 9.1 percent. On a wireless bill, even though they have a cap at 28.5, or they may

even come in and show their own unique study and they can have a study that says 20 percent, if 20 percent is what percentage of their minutes are interstate and the factor is 9.1, 20 percent of 9.1 is roughly 1.8 percent. So on a wireless bill, you see 1.8 percent. And if that customer—because you make your decisions not in the aggregate, not in the average, you make your decision, as a customer, customer by customer—so that customer sees 1.8 percent on their bill. They are a heavy interstate user. What they see on my bill is 9.1 So, unfortunately, from my point of view, the current system, with the safe harbor concept, is an anti-competitive issue with regard to long distance carriers.

Not only that, I just want to highlight international exemption. There is an international exemption, such that if 88 percent of your traffic is international and only 12 percent is interstate, then you are assessed on only the 12 percent. So that is harmful to me in the competitive marketplace, but it is also harmful to the Universal Service Fund, because they would have 9.1 on all those international revenues when that customer is using me; but when they go to a wireless vendor or another vendor who has a niche—I am not saying wireless vendors have a niche in the international market; but to the degree there are vendors out there, and I can highlight to you who they are, who have international disproportionate traffic, the USF fund is not going to generate the same level.

All of these things are reasons of why the bits, the calls are still out there, but you have Internet substitution, you have wireless substitution, you have safe harbors, all of these things are contributing to why this fund is being assessed on interstate revenues. And unfortunately, the demand is still there; it is just being accommodated in different ways.

Thank you.

Senator BURNS. Mr. Orent, you have heard his explanation of that. Do you agree completely with that view? And what would you, on your recommendations—give me an idea on how we solve this problem.

Mr. ORENT. Well, I—

Senator BURNS. Pull that microphone over there, by the way.

Mr. ORENT. I do agree with a good deal of Mr. Lubin's comments on this issue. From our perspective, it simply is not fair to have interstate traffic being allocated in different sorts of ways amongst different types of providers. The safe harbor, to me, is just not a fair system. It should be something that treats all of us with a greater deal of equality and parity in terms of how we contribute.

I could argue that, in the case of my own company, I really do not provide any long-distance service. I provide access to long-distance providers, but that does not give me any relief in terms of the degree of contribution that I have to make. I have to make the same contribution that everyone else does, because I facilitate access to the long-distance network. So, to me, in terms of fairness, we should all be held to the same contribution standard, and the safe harbor does not accomplish that.

Senator BURNS. Mr. Hughes, would you like to comment on that? You are a wireless provider.

Mr. HUGHES. Yes, sir. We think that the safe harbor does provide a useful tool, but comes with problems of measuring the interstate

provisions. And there are a lot of anomalies and different things about the Act and the way it is administered now that it is one way for one carrier and another way for another.

For example, the ILEC has the opportunity to recover all of its costs over a period of time through the Universal Service Fund. The wireless provider, while we are grateful to be included and while we are thankful for what we have, and were it not for what you have given us, we would not be able to do what we have done, does not have that same opportunity. There is so much talk about—it should be based on the cost of the provider. If that were the case, probably the wireless providers would be better off. Our return is not based upon the same costs that the ILEC uses, but is different. We get a per-line and we have to have a customer and we get the same amount per line, but there is no guarantee, if we build a tower in a high-cost area, that we are going to recover that money.

So there are a lot of things about the Act that probably are different from one to the other, and there may be some wisdom for having some of those differences. And again, we are thankful just to be at the table, and we are thankful for what we have had. We are making good use of it. But we think the safe harbor is a useful tool because of one of the problems, it is so hard to measure what your interstate traffic is, and it is just one of the problems that exist out there.

And maybe there is some better solution. Maybe the FCC could come up with something better. But until that happens, we think it is a useful tool, and we think it should remain unless we are going to go out and we are going to straighten out all the other differences in there. Just to focus on that one would seem to be—and especially since the wireless providers are putting in now 11 percent or so of the USF funds, and they are extracting—I think the figure of 2 percent was used by the commissioner earlier today—2, 3 percent. We think we are contributing our fair share to it, and we just, again, appreciate you all letting us come and use it for the benefit of our rural consumers. We thank you for that.

Senator BURNS. Mr. Dosch?

Mr. DOSCH. I am wondering which point to address.

[Laughter.]

Mr. DOSCH. I guess going back to your original question, there is a simple, a relatively simple, solution to the problem that safe harbor is attempting to address, but it does require a legislative solution. But it is quite simple, and that is that Congress should go back and allow the FCC to ignore the jurisdictional nature of telecom traffic and to simply base its estimates into the USF on interstate and intrastate revenue, as well as revenue derived from substitute services, competitive services. By eliminating the jurisdictional distinction, you no longer have to worry about attempting to identify which subset of the traffic is truly intrastate versus interstate. And I think that its simplicity is compelling and something that Congress should definitely consider.

Senator BURNS. Sometimes the simplest answers work the best. Dr. Gillis?

Dr. GILLIS. That would be my primary statement, is that the simplest often works the best. But when I was asked to comment

to the FCC on the collection mechanism, I used the analogy of, really, the choice between fixing up the old truck or buying a new one. And in many ways, the whole concept of the safe harbor is taking an existing collection mechanism that has been used historically in a time when wireless was a fairly small player and it was primarily the traditional IXC base for universal service. But, as I mentioned in my testimony, the world has changed. And I would agree with the points that were made by Mr. Lubin, primarily, on the difficulties of that, but I do not think that is the solution. I really think it is time to put forward a different collection mechanism that provides a much broader base than currently, and it needs to be fair.

I guess the other comment I would make in response is that to the extent that we are broadening the base of collection and doing it in a manner that is fair, of course, it has to be lawful, but those that contribute to the funds should also have the ability to collect from the Fund. And so I think that involves kind of a more—that we should not look at this issue in isolation, that I am completely in agreement that the first priority should be fixing the collection mechanism, but that should not be where our job stops, because we really have to think about the proper way to allocate the Fund afterwards, to be fair.

Senator BURNS. Let me also ask another question. The FCC is providing sufficient oversight in designated ETC status for new carriers. In your opinion, have these additional designations had the desired effect of providing better service in the public interest? And also, are there issues of fairness that require changes in the legislation?

Mr. Hughes, do you want to respond to that one? We will have everybody respond, but—

Mr. HUGHES. Yes, sir. We think that the criteria set out in the Act and as it is being administered now is a fair method for determining ETC status. We have heard a lot today about different things. And maybe additional regulation over the wireless provider when it comes to, you know—it seems to me that it should be going the other way. Regulation, as I was taught it, was when you had a monopoly and there was no competition out there.

We are moving into a competitive situation. The wireless provider has significant competition. Its practices and costs are regulated because we have to do the things to be able to sell the service and compete with the other service provider. If the people do not like it, they can always go somewhere else.

But, nevertheless, the suggestion that there is no regulation probably is not well founded, in that in our State the attorney general's office, consumer practices—plus each year we have to have our ETC status approved by the Public Service Commission. And the moneys that we spend, we are required in a reporting procedure before the Mississippi Public Service Commission to tell them where we are going to spend the money, and then every quarter we have to provide them a report showing them how we spend the money. And while they may not have a statutory authority to regulate what we are doing, let me assure you, when I get a call from the Mississippi Public Service Commissioner suggesting we have a

service problem, it has a regulatory ring to my ear. I respond to it.

And tonight I am going to go home to Mississippi, I am going to go home to Brandon. Tomorrow, I am going to get up and I am going to see those people that we serve, and they have found out that since I am in the communication business, I have a telephone, and they are calling me.

So our customers are regulating us. The Mississippi Public Service Commission is, de facto, regulating us, and they get the call and we respond to it. And also the Mississippi attorney general's office, through its consumer affairs.

So we do have some regulations out there, and we think that just the competition alone—instead of looking for more regulations, I would suggest that maybe we ought to be moving toward less regulations.

Senator BURNS. Mr. Dosch?

Mr. DOSCH. Mr. Chairman, as you know, the handful of provisions in the Act that, in the aggregate, go to the idea of the competitive ETC, state that the FCC "shall," in the case of non-rural areas, and "may," in the case of rural areas, "designate additional ETCs." It is my opinion that the public-interest bar has not been raised high enough in the case of competitive ETCs in rural areas that are receiving high-cost support. And I think the core question—I have heard this referred to as a "reverse unfunded mandate"—

[Laughter.]

Mr. DOSCH.—in that there is free Federal money to be had by the commission, the State commission, making a very easy determination that a competitive ETC would be in the public interest in that particular area, but that there is no or very little corresponding direction from the FCC or from Congress as to how that public-interest determination should be made or used.

I would just point out that we do not have competitive ETCs in my area, in the area that my company serves, but we certainly face competition from seven very robust wireless carriers. My company is actually considering a marketing campaign touting the benefits of wireline service, which 15 years ago would have been silly. It would have been like trying to market indoor plumbing or drinking water. I mean, it was a non-issue. But now we very much consider the wireless carriers in our area very robust competitors and we are seriously marketing against them, as they are us.

That is all well and good, and that is fine, and if that competition can be sustained in more rural areas, that is great for those customers. And we are certainly not attempting to wall off any area from the benefits of competition, if competition is sustainable. However, when the issue becomes the receipt of universal service support to go to a competitive company which is essentially building an overlay network so that you have two networks in a particular area where it has been previously determined that that area will not support one network on its own, that raises a different issue, and I think it is incumbent upon Congress and the FCC to make sure that Federal revenues going to such situations and flowing to competitive ETCs is truly in the public interest, and I do not think that has been happening up until now.

Senator BURNS. Mr. Orent, do you agree with that? Do you agree with—yes.

Mr. ORENT. Yes, I do, in many respects. And I would also like to suggest that in a document that one of the organizations I represent prepared, we have specific recommendations with regard to criteria that would apply to the public-interest standard, to the qualifications, and to the requirements that would otherwise treat all of us equally and would help ensure that when ETC status is granted, it comes closer to trying to meet a public-interest standard, which, from my experience in the State of Michigan, has been totally ignored.

Our greatest threat to the universal service, from my experience in that one State, is simply a total disregard for what Congress intended when it separated non-rural and rural areas and recognized that in rural areas, granting additional ETC status may not always be in the public interest based on the economics of the area in question. And it was appropriate to leave that to the States.

Unfortunately, too many States have looked at this as a welfare opportunity to help their States and have adopted an attitude that says, "If I can get free money from the Federal Government for my State, that is in the public interest and that is good enough." And I have seen applications pass through the Michigan Public Service Commission quicker than any other documents I have ever seen them act upon.

There has been no assumption of a responsible role to ensure that congressional intent with regard to measuring public interest has been met. And I am very fearful that that type of attitude is being adopted nationwide and is adding to the difficulties we are having with regard to managing this scarce national resource, the Universal Service Fund.

And I would also like to clarify, if I may, Mr. Chairman, that fact that all too often we hear that State regulators want to hide behind the fact that they have no authority to regulate some carriers—i.e., wireless carriers. I think it has been established clearly that, with regard to universal service, States have all the authority they need to impose terms and conditions relevant to participating in the Universal Service Fund. That has already been established by the courts. Unfortunately, it just does not seem to be convenient for them to be aware of that.

So I think this—

Senator BURNS. Why would you say they would duck such an issue because most State PUCs do?

Mr. ORENT. Because until the 1996 Act was passed, and this is my opinion—in my opinion, until the—

Senator BURNS. That is all we deal with up here is opinion.

[Laughter.]

Mr. ORENT. Well, thank you.

In my opinion, until the 1996 Act was passed and codified universal service, most State commissions never really had to concern themselves with the intricacies of a very complex system. And many of them, I am saddened to say, still do not fully appreciate or understand the system. And in some cases in the State of Michigan, there has been a process by which the leadership has been made to believe that a universal service system at the State level

is bad. Let us not do it. They have thumbed their nose and ignored what has been an opportunity since 1996.

So I do not know what else might motivate State commissions to want to duck their true responsibilities, as intended by Congress. And furthermore, the FCC has exerted not one iota of effort to hold any one State accountable for what it is that they have delegated to them through their rules and regulations.

So we have a breakdown in terms of the delegation without any follow-up for accountability, in terms of 50-some States being able to treat things however they find politically convenient. There are few States that have addressed this issue. But those States, like the State of Utah, which has denied multiple ETCs in rural areas, they were motivated to do that because they have a State universal service system, and this would have had implications on that State's universal service system's size. So they are one of the few States that I am aware of that has really done a proper job of ensuring that the public interest is met.

And to the extent that—I believe it was Matt's recommendation—that States be required to fund some of these things, I think it is absolutely a great idea that they get some skin in this universal service game and do not just look at it as “free money.”

Senator BURNS. We will come back to that. Have all of you had an opportunity to look over what Mr. Lubin, of AT&T—his recommendations on some of the solutions, have you had a chance to look those over, and can you comment on what they have proposed? And if you have not, why just say you have not looked it over.

Mr. HUGHES. Mr. Chairman, I have not had an opportunity to look it over, but I will be glad to supply you, after a chance to read those comments, if the Committee would allow me to do that.

Senator BURNS. I would accept your offer on that. I would like for you to look at it and give me some sort of a short white paper on what you would think about it.

Mr. HUGHES. Yes, sir.

Senator BURNS. Anybody else? I noticed there was—and also, when we are talking about your ETCs, portability comes into question, I think. USF support is portable to competitive eligible telecommunications carriers in concept. It would seem that when Customer-A switches from ETC-A to ETC-B, or A should lose the USF support on that line, and ETC-B would gain it. It is my understanding, however, that the incumbent ETCs do not lose any support as a result of this competitive entry. Should portability be implemented so the ETCs receive support only for the customers that they serve? Anybody want to comment on that?

Yes, sir. Dr. Gillis?

Dr. GILLIS. Yes, sir. I mean, tying this back to the conversation that you were just having a moment ago of why State commissions perhaps have not taken a great deal of time on some ETC decision—and I actually sat on, I think, one of the first—as a State commissioner in the State of Washington—on one of the first multiple ETC decisions on mobile wireless in the country, and that was 1998. And a petition came in in December 7, 1998. It was revised December 20th, 1998. And the majority of the commission acted in favor of granting multiple ETC designation on December 29th. I dissented rather vehemently about it not having enough process to

look into it, but it was a very short process. And as you can tell, it is not because I discourage competition, but it is because I think it is a very important responsibility.

But the reason I think perhaps some State commissions have not—and I think it varies, because I do not think you can make a uniform statement; different commissions are different in the amount of effort they have taken in the public interest evaluation—but it is partly because of the portability issue and the skin-in-the-game issue, that right now, you correctly stated, that the rules, the FCC rules, allow the competitor to receive ETC support for all the lines that they have, whether they are captured from the competitor or not, and, unfortunately, at least in my view.

I mentioned to you about the Rural Task Force, and we did have a consensus recommendation on a variety of components of universal service, and the Rural Task Force had incumbents, it had competitors, it had some wireless, it had IXCs, it had consumer representation. For the most part, the FCC accepted the Rural Task Force recommendation, except for one provision that I think has turned out to be important, on portability. The Rural Task Force recommended that, at the time of competition, when a State commission grants a multiple ETC designation, that the universal service support in that area be frozen at the level it is at and it would be allowed to grow for both the incumbent and competitor at a growth factor which—essentially inflation plus some line growth, but the competitor would only receive support for the lines that it captures.

And that, I think, in my view, was an important recommendation of the Rural Task Force. It was not followed through on, for some good reasons; but, in hindsight, I think that is one that could help one put skin in the game, because right now if you are sitting on the State commission with many, many multiple obligations to take care of—and I think commissions, in general, State and Federal, do not have the resources they need to do their job in these times where there are so many complex things going on. And so I am not bashing commissions. I think they do a wonderful job, but if you look at it from the standpoint of harm, it is very hard to say you are harming an incumbent carrier, because they are not losing money out of the deal. And then there is more money flowing outside of the cap that is going to the competitors. So there is no skin in the game in that sense. And I think that that is important that perhaps that be looked at.

Senator BURNS. Mr. Hughes?

Mr. HUGHES. May I just speak from a real-life experience that we are currently having? Were we restricted to getting Universal Service Fund only on new customers, we would not be today offering the \$49-a-month, all-you-can-eat unlimited across the State of Mississippi. We would not have a new CDMA 1X system in. We would not be where we can compete with the ILEC. It just would not have happened in our case.

There may be some better answers somewhere, and maybe the future will bring it, but for the current time, I think if Congress really wants to use the USF fund and really wants to promote competition, it is essential that they continue the current practice of portability, which, as has been mentioned, does not harm the in-

cumbent, but provides sufficient incentive and sufficient moneys to the company who is building a new infrastructure. And they say it is a second infrastructure; well, it is an entirely different infrastructure. It is one that allows them the benefits their city cousins have of using that wireless phone. And the city cousins benefit because they can find their friend when he is out in the field. The farmer can have his office on his tractor.

If the Congress wants competition, and certainly for the time being and until some new substitute that is better can be found, portability is important. And we do, again, mention that the portability in its current configuration does not harm the ILEC; it only benefits the rural consumer by making available to him something he would not have had before and something that may be a long time coming, if ever coming, to his area without that portability factor. And that is our real-life experience with it.

Senator BURNS. Mr. Lubin?

Mr. LUBIN. Yes, Mr. Chairman. I would like to actually comment on the last two questions, because, from my perspective, they are wonderful questions because they highlight, unfortunately, the complexity in the interaction of many of these issues.

First and foremost, I am going to just try to give you my sense of urgency and passion, if you have not seen it yet. And that urgency and passion is that the assessment mechanism is broken. And so what we are talking now about, an assessment mechanism that is broken, where interstate revenues are declining. And I just heard the wireless representative talk about another example where there is a flat-bundled offer of whatever it was, \$49. How do you take that \$49 and allocate it? And it is not just wireless carriers that are doing it; it is other wired carriers that are doing it. I am doing it. Right? I have a 1995 bundled offer, all you can eat, and I can explain the details of it.

But the issue is, How do we allocate this between interstate and intrastate? And what are the incentives for people to put more and more of it in the intrastate side where it does not pay, and on the interstate side, where it does pay, you are getting less and less?

So my passion here is that the ETC is a wonderful question, but it is a complex and confusing question because, on one hand, as Mr. Gillis has said a few times already, he sees the twin goals of preserving and advancing universal service in competition. I am there. I want to see all of those things happen. On the other hand, I see an assessment mechanism that is broken.

Let us, for the moment, ask the question, If wireless carriers around the country get ETC status—let us assume they get it very quickly. Let us assume they are not even going to compete for the first line in the household. We can debate everything. But let us, for the moment, assume that the first line is not competed; and, in fact, what happens, every household in the rural areas, because they are getting more money from USF, God bless, and they are putting in infrastructure so the holes do not exist and you get good quality service, such that every individual in a household in a rural area now has a wired line and a wireless line. And by the way, they may have not just one wireless line, but if they have a wife and two daughters, like I do, they may have four wireless lines. And so all of a sudden, not for the first line, not for the second line,

but for every line connection, wireless, wired, in a household, if they are in a rural area, they get the subsidy.

Now, for the moment, I am not taking a position of whether that is good or bad, but what I am saying is that the quick calculation I just did is if that happened, the size of the Fund would grow between \$1.5 and \$2 billion. And my point is, first and foremost, we have to fix the assessment and collection mechanism. We have to figure out an assessment mechanism such that the widgets that we are assessing are not declining year over year, but the thing we are assessing is growing. My concern about solving it through jurisdictional legislation—and I am all for trying to broaden that base, but if I use a jurisdictional solution and we do not address information services, we do not address the Internet, you are going to have leakage.

Fundamentally, you need a solution that is broad and eliminates, to the extent possible, leakage. Because if you do not do that, we will be back here when we look at interstate and intrastate revenues and, in the aggregate, they start to decline.

Back to my ETC question. The ETC question is, before I get to that, I need an assessment mechanism fix. Once we have a rational assessment mechanism, then we can ask the question, Should we have multiple lines, whether they are wireless or wired, in a home, should all of those connections get a subsidy? And when you ask that question, you had better be looking at what the bottom line is. And if we can fund that and support that, that is wonderful. If we cannot because all of a sudden—this value in my example is a dollar. Quite candidly, you can take it up to a \$1.10 and \$1.20 and you might be able to get coverage virtually everywhere for wireless. You may be able to do other things. So what I urge is, take a hard look when you answer the question about ETC status.

And again, I am for competition, I am for giving rural customers and urban customers choice, I am for giving them as much, but you have to ask the question. When you do that, you have to have a principled basis and you have to be looking at what the bottom line impact—because it is not these carriers, me included, who are paying for this. It is our customers who are paying for it. And that is why ultimately we ought to be asking the question, What is the simplest thing to do? What is the least customer-friendly thing to do? And what is the most cost-effective way to manage this?

Because four out of the five parties up here are saying the problem is significant, it is broken, and they are looking for a solution. And when I think about that, we all have a commonality of interest. We are striving for a solution, we do not want leakage, we want to have it done in a timely way. I look at that and I say to myself, Why can we not find a solution that we all agree to? Because we all see it as a problem.

Thank you.

Senator BURNS. Yes, sir.

Mr. HUGHES. While I am going to respond to the other comments he has with AT&T, let me just make my position clear in regard to the growth of the Fund. I am not so sure the figures he has are accurate. But, nevertheless, there is substantial growth in the Fund.

The point we were trying to make is that the contribution to the growth in the Fund and the withdrawals from the Fund by the wireless providers is really very small in relationship to the 1.1 billion the ILECs got a very short time ago. The chart that is provided to me by the OPASTCO company shows that relationship, and I will be glad to give that to the Chairman if you would like, and to the Committee, but it points out that the ILECs were getting 2.05 billion in ILEC support in 2000, and they are getting 3.17 billion in ILEC support currently; whereas, the wireless support has run from minuscule, almost not on this chart, to \$120 million currently.

And our point is, I guess, we hear our name offered so often as being the problem, and we just ain't the problem.

Senator BURNS. OK, well, this is——

Yes, sir. Mr. Orent?

Mr. ORENT. If I could just make one comment on the portability issue.

Senator BURNS. Yes.

Mr. ORENT. You so correctly stated when the act was initially crafted it did envision, it did intend, for support to go from one to another, because it was assumed that there would be some obvious way of determining that this customer, who used to reside with this carrier, is no longer with that carrier, has now gone over to this competing carrier. Well, that is not what has evolved, and the rules that have been promulgated have really messed up this entire portability in a big sort of way.

We believe that when you look at—using wireless as the best example, wireless, in many cases, does not take away a wireline customer from an incumbent local exchange carrier. I believe that, in many instances, what you have here is this notion of not direct substitutability, but of a complementary sort of service where it seems, in many instances, a customer with both wireline services and with wireless services is relying on the wireless forms of services as a substitute for long distance, as opposed to a substitute for local service. So it is more of a complement to the local service, a substitute, in many cases, for the long-distance service.

What has happened, obviously, is, they are not taking support away from us, giving the support, based on our costs to the competitor, exasperating the size of the Fund. And part of it, I believe, is because there is not a means or a method available that would allow those who administer this thing, the NECA or USAC organization, to be able to properly verify what is happening.

So, the administrative back-office types of things that would have to be dealt with in order to verify that a customer has actually discontinued service at one location in order to have service with a competing carrier is a huge administrative nightmare. And unfortunately, this now allows for an awful lot of gaming that sometimes goes on in order to maximum universal service receipts by the competitive element.

So it is a huge, huge problem that the FCC has created by its choice of how it administers the rules and directs NECA that really needs to be squarely addressed.

Mr. HUGHES. Mr. Chairman, if——

Senator BURNS. Yes, sir.

Mr. HUGHES. I guess, to quote President Reagan, "There we go again."

[Laughter.]

Mr. HUGHES. I feel so popular here, because everybody—and it may be the bow tie, I do not know—

Senator BURNS. This is the way we learn things.

Mr. HUGHES.—but everybody seems to like me.

Senator BURNS. If we can get this little debate going at that table, we'll learn a lot of things here.

Mr. HUGHES. And that is why I wanted to inject here, because of the suggestion here that cellular or wireless service is just an ancillary service. You can look around here in Washington, walking down the street, people are depending on this not for—they are not walking down the street on a long distance. They are talking to home, they are talking to mama, they are talking to caregivers, they are calling their children, they are talking to their office. They are doing things locally. That is why our all-you-can-eat in Mississippi—that is a local service, in Mississippi, all-you-can-eat, \$49—is so very popular, because it is within the calling area, it is for the people they are calling.

So we would strongly suggest that wireless service is not an ancillary service. Wireless service today has become a necessity. It is important. And it has advantages that the wireline service cannot offer in portability, and the ability to make that 911 call when you have the accident instead of having to get out, limp into wherever a phone is and make the call from there. You can call right away. There are some tremendous advantages, and it is not merely ancillary, although it may be deemed that by some. It is an important necessity in the American life today that the rural people of this Nation are entitled to have and use and have the benefit of. And that is what you have let us do by letting us use the Universal Service Fund, and we thank you for it.

Dr. GILLIS. Mr. Chairman?

Senator BURNS. Yes, sir.

Dr. GILLIS. I want to be clear, also, that I agree with that assessment, and I think I testified to that, that I view wireless service, as part of a comparable bundle of services, should be available to rural Americans. I think the issue is not should we have quality wireless service available to rural Americans, but is the mechanism we have today appropriate to accomplish the goals of deployment of a comparable network, including quality mobile wireless, access to broadband, and a choice of dial tones? And in my view, we have to return to the mechanism, but the way that the rules are currently set up for portability, in my view, distract from that goal. So we need to revisit that.

Senator BURNS. This has been a very enlightening panel. I want to thank you for coming this morning. And there may be questions by other Members of this committee, and they will do that in writing. We are going to keep the record open. If you would respond both to the Committee and to the individual Senator, I would certainly appreciate that.

I have got more questions here. We have another panel to cover. But it has been very enlightening. And thank you for your interest in this, because I just think it is very, very important that we ad-

dress this now and take your testimony, your recommendations, and also your situations to make it fair and to move either legislation or make the recommendations to the FCC and the Universal Service Board and to put it in place so that we can start getting back to the business of promoting competition and also extending those services to areas like there is across the country. We kind of like to make everybody alike, but then nobody wants to be alike. And thank goodness we have that kind of a mindset. But it also adds to the complications of making good policy, too.

So I appreciate you coming today, and thank you, and if there are other inquiries, why, please let us know. The record will remain open for a couple of weeks yet.

Mr. HUGHES. Mr. Chairman, I have a procedural question. I offered this chart.

Senator BURNS. Yes.

Mr. HUGHES. Should I—

Senator BURNS. It will be made part of the record, and the clerk will—

Mr. HUGHES. Then I should submit it—you will have it submitted?

Senator BURNS. Yes, it will be made part of the record.

Thank you very much. We will go to panel No. 3 now.

Panel No. 3 is Tom Meade, Vice President of Regulatory Requirements, Alaska Communications Systems, out of Anchorage, Alaska; Dana Tindall, Senior Vice President, Legal, Regulatory, and Governmental Affairs for General Communications, Incorporated, Anchorage, Alaska; and Jack Rhyner, President and CEO of TelAlaska, from Anchorage, Alaska. My gosh, we might as well be the Alaskan PUC here today.

[Laughter.]

Senator BURNS. But we are looking forward to your testimony on this important thing of universal service and how it applies to a State that basically is why universal service was set up in the first place, is so that we can get affordable—

Could we have order, please, in the hearing room?

The basic reason for universal service in the first place was to deal with States just exactly like Alaska and Montana.

We will start from the top, Tom Meade, who is with Alaska Communications Systems out of Anchorage. And thank you, Tom, for coming today. We appreciate it very much.

STATEMENT OF THOMAS R. MEADE, VICE PRESIDENT OF REGULATORY REQUIREMENTS, ALASKA COMMUNICATIONS SYSTEMS

Mr. MEADE. Thank you, Mr. Chairman. I am substituting today for our director of Regulatory Affairs. I am sort of a last-minute substitution, and I apologize if I am not as polished as some of the other speakers. But I am essentially the numbers guy who has been dealing firsthand with the implementation of the regulations from the FCC as they have been required to be implemented by our regulatory commission.

And while I share the concerns of the other ILECs about the adequacy of the funds, I would like to focus on how it will affect, how the administration of the current fund affects our customers, even

if it remains fully funded. We face the most severe competition in the country, and our situation is likely to be a precursor for rural subscribers in the rest of the Nation.

The Universal Service Funding has been very effective. Without it, there would not be service in many areas, much less competition in many areas. There are areas as small—we have exchanges as small as 20 lines, and in many of those areas there is no competition for other basic services, such as grocery chains or fast food or fuel dealers, *et cetera*.

But, unfortunately, the way the FCC regulations have been interpreted and implemented by our State regulators, universal service is being threatened in many of these areas.

The adequacy of universal service in our exchanges depends upon whether competition is allowed to develop naturally or whether we have to subsidize our competitors. And unfortunately, that is what is happening today. CLECs can buy our loops below what it costs us to provide them, and yet they have access to the same revenue per line and the same universal service per line that we do. They have no obligation to invest in loops, and ultimately this will make it impossible for us to provide quality service.

A lot of the focus that we have had today has been on wireless. Our problem is with competition through unbundled network elements where we have to sell them to our competitor below cost.

And one of the things that I have seen mentioned here and I agree with today is that the rural exemption and ETC status has been granted fairly casually by regulators without examining the effect on the public interest. In our service area, for example, we have lost our rural exemption for communities as small as Seldovia, which is not even on the road system; it is accessible only by boat or airplane, it has less than 400 lines, yet we no longer have a rural exemption there. And it seems to be based purely on the idea that competition will reduce costs and provide better service. And I believe, in many cases, the people who are purporting that that is the truth are taking credit for technological advancements that really were unrelated to the advent of competition in the rural areas, but taking credit for the microchip, fiberoptic, and laser technology.

When I first went to Alaska, we had long-distance service through 1950's troposcatter systems; and microwave and laser technology and fiberoptics have changed all that and reduced costs, digital electronic switching, *et cetera*.

But once we lose the rural exemption, our USF becomes portable to the CLEC. It becomes portable on a per-line basis under FCC regulation, and based on our actual cost, that means we spend the money and our competitor recovers it. When our competitor is granted USF for unbundled loops, the only way we get a chance of recovering our cost is when the UNE rates are high enough. When the UNE rates are as high as our actual cost, then we are made whole, but only then. And with the advent of UNE pricing under a, quote, "forward-looking" or, in other words, "make believe" methodology, we never recover our costs.

Our UNE rates in Fairbanks to our competitor are \$19. It costs us \$34. First, we cannot compete by giving our competitor a \$15 advantage. And second, they get the USF associated with that loop.

Now, I have heard CLECs say that service will not be jeopardized if we do not recover our costs, because we have an obligation to provide service. It is true, we are a carrier of last resort, but our investors do not have an obligation to provide money. There is no such thing as an investor of last resort. Ultimately, the system has to be self-sustaining.

I have heard CLECs claim that ILECs are inefficient and that is why the Fund is bloated. But in going through UNE proceedings, we have found that when GCI has tried to build their own facilities, they have actually spent more per loop than we have.

We have heard that competitive neutrality requires equal USF. We believe that competitive neutrality requires an equal obligation to invest in infrastructure to serve everybody. And if competitive neutrality means that we all play by the same rules, that means that competition should also bring deregulation.

That is why we are here before you today. We are hoping that because of the way some of the Telecom Act has been implemented, that you can help cut through some of the problems with clarifying legislation or prompt the FCC to act quickly.

Thank you. I appreciate the opportunity to testify today.

Senator BURNS. Thank you, Mr. Meade, and your complete statement, if you summarized part of it—I did not read your testimony, but it will be made part of the record. And I appreciate that very much.

[The prepared statement of Mr. Meade follows:]

PREPARED STATEMENT OF THOMAS R. MEADE, VICE PRESIDENT OF REGULATORY
REQUIREMENTS, ALASKA COMMUNICATIONS SYSTEMS

Introduction

On behalf of Alaska Communications Systems (“ACS”), I would like to offer the following testimony to the Senate Commerce Committee and its Communications Subcommittee on the critically important topic of the future of Universal Service and the ultimate viability of the Federal Universal Service Fund. ACS appreciates the invitation to address the Subcommittee. I hope that ACS’ comments will prove both valuable and provocative. ACS stands ready to respond to any follow up inquiry that the Subcommittee Members might have.

ACS’s primary business is that of local service and exchange access services via four separate local exchange companies operating in the largest urban and some of the smallest rural communities in Alaska.¹ In addition, ACS offers wireless, Internet and long distance services through affiliated business units.² While new technologies and competition continue to prompt advances in products, services and the efficiencies of service delivery, the practical reality of serving rural America—and rural Alaska in particular—cannot be overlooked. ACS’ testimony today will focus on this reality and the need for Congress, the FCC and state policy makers to remain vigilant in protecting universal service objectives and resources.

We must not lose sight of the ultimate goal of the universal service program—that is to provide high quality, reliable and affordable telecommunications services to the greatest extent possible throughout the country. The desire to enhance opportunities for competitive market entry may be laudable, but must never be allowed to compromise the overarching goals of universal service. Congress clearly had this in mind when it created the delicate balance between competition in the local market and the strong endorsement of universal service fund in the Telecommunications Act of 1996. Unfortunately, over the last seven years, the FCC and the states have opted to tip the balance in favor of competitive entry in ways that now threaten preservation of universal service principles. ACS has repeatedly advanced the caveat that continued growth of the Federal Universal Service Fund (“USF”) cannot

¹ ACS of Anchorage, Inc., ACS of Fairbanks, Inc., ACS of Alaska, Inc., and ACS of the Northland, Inc.

² ACS Wireless, Inc., ACS Internet, Inc., and ACS Long Distance, Inc.

be sustained. While periodic review of Universal Service Funding to reflect changes over time is sound policy, the idea that the Fund can grow exponentially and indefinitely is unrealistic.

Recent additions of new categories of support have already stretched the limits of USF. These additions have prompted new and expanded end user fees. When viewed together with other significant flow-through charges reflected on the customer's bill, such as the successive rounds of increases to the Subscriber Line Charge, the whole process is likely to crumble under its own weight. Representatives from densely populated "payer" states have already drawn a line in the sand arguing that they can no longer shoulder the ever increasing burden. Congress, the FCC and state policy makers must recognize this reality and take steps to properly balance and focus USF resources or face the dire consequences of failing to do so. ACS offers some specific examples and suggestions in response.

Universal Service in Alaska

ACS serves numerous rural communities in Alaska. USF funding is essential to ensure that rural subscribers have affordable telecommunications services that are comparable to the services provided in urban areas. Consequently, ACS has a strong interest in the integrity and continued availability of USF.

Unfortunately, existing Federal Communications Commission ("FCC") rules allow USF to be distributed in ways that are inconsistent with the purposes of universal service support set forth in Section 254 of the Telecommunications Act of 1996. We believe Congress should be interested in this misuse of USF. Such improper use results in increased pressure on limited resources and creates "perverse incentives" to compete for subsidies instead of for customers. In addition to the direct threat to rural consumers, misuse of USF resources creates an impediment to investment and service improvements (including both basic telephone and broadband) in rural areas.

Section 254(e) of the Telecommunications Act of 1996 requires, in pertinent part, that a carrier that receives Federal universal service support use that support only for the provision, maintenance and upgrading of facilities and services for which that support is intended.³ The FCC has identified the high cost carriers entitled to support from the High Cost Loop Fund as those with embedded loop costs in excess of 115 percent of the national average loop cost. In other words, eligibility for high cost support is directly related to the degree to which a provider's loop costs exceed the national average. Under current rules, that means a local loop costing in excess of approximately \$23 per line per month is eligible for high cost support.⁴

Improper Use of High Cost Loop Support in Alaska

The misuse of funds and inefficient competition for subsidies stems from Section 54.307(a) of the FCC rules.⁵ Under 54.307(a), competitive eligible telecommunications carriers ("CETC"), including wireline CLECs in Alaska, receive Federal high-cost loop support ("HCLS")⁶ for each line served based on the support the ILEC would be entitled to receive. This per-line support amount flows to the CETC for each line regardless of the competitors' actual cost associated with that line.

The situation confronted in Fairbanks, Alaska offers a vivid example of the problem. In Fairbanks, ACS' per line cost is approximately \$33.50 per month making it eligible for about \$10 per line per month of support for its local loops. Most of this comes from the High Cost Loop Support fund. Alaska's State commission, the Regulatory Commission of Alaska ("RCA"), however, has required ACS to lease these same Fairbanks loops to its competitor, General Communication, Inc. ("GCI"),

³ 47 U.S.C. § 254(e).

⁴ 47 CFR § 36.631. The Commission decided to freeze the "national average loop cost" for this purpose at \$240 per year for the duration of the five-year plan, which became effective on July 1, 2001. Accordingly, a rural ILEC, whose embedded loop costs exceed 115 percent of \$240 (approximately \$276 per line, per year, or \$23 per month) generally is eligible for financial support. These calculations tend to change slightly over time, but the underlying relationships described in this testimony remain basically the same.

⁵ 47 C.F.R. § 54.307(a) provides, "A [CETC] shall receive universal service support to the extent that the [CETC] captures the subscriber lines of an [ILEC] or serves new subscriber lines in the [ILEC's] service area." Subsection (1) of this rule further provides, in pertinent part, "[a CETC] serving loops in the service area of a rural [ILEC] shall receive support for each line it serves in a particular service area based on the support the [ILEC] would receive for each such line, disaggregated by cost zone if disaggregation zones have been established within the service."

⁶ As used here, "High-Cost Loop Support" or "HCLS" refers to: (1) high-cost loop support (formerly known as "universal services fund"); (2) Long Term Support ("LTS"); and (3) Interstate Common Line Support ("ICLS").

at the deeply discounted rate of \$19.19 per month.⁷ Despite this low cost of the loop to GCI, a cost substantially less than the \$23 per line per month threshold otherwise required to be eligible for any cost support, current FCC rules appear to entitle GCI to the same \$10 per line per month support that ACS receives.

In Alaska, then, allowing the CETC to receive the same support as the ILEC is a rule that can and does produce absurd and improper results. Because GCI does not have high cost loops, as defined by the FCC, any high cost loop support received by GCI will necessarily be for a purpose other than to purchase, maintain or upgrade high-cost loops as required by the Act. Furthermore, Section 54.307(a) can and does result in huge windfalls for CETCs, which, by definition, also means that USF funds are not being used for the purposes for which they were intended.

Such misuse violates the principle of competitive neutrality⁸ and rather than promote efficient competition instead allows inefficient carriers to enter the market and compete based on these unlawful subsidies. Perhaps more importantly, such misuse puts continued stress on finite USF resources, ultimately threatening the very viability of a program that has for many years served the interests of consumers in high cost rural markets.

Congressional Intent Ignored

Congress should be concerned that its policies, as set forth in the Telecommunications Act of 1996, are not being implemented as intended. There has been some concern expressed that asking a CETC that provides service on its own facilities to submit cost information in support of a claim for USF assistance would be overly burdensome. ACS finds this argument specious. ILECs have been required to provide such cost rationale since the inception of the Fund. It does not appear to be any more burdensome for other facilities-based providers to justify their need.

The argument totally falls apart when dealing with a CETC that serves customers via UNE loops. Where a CETC's loop costs are known and documented, such as when the CETC purchases UNEs at a state-sanctioned rate, there is no burden in identifying the CETC's actual loop costs. In such cases, USF support should be based on the CETC's own per-line costs—that is, the UNE loop price it pays—not on the costs of the ILEC.⁹ GCI argues that its loop costs include other elements beyond the UNE price it pays to ACS. Although there may be some other costs involved, USAC rules limit recovery of certain cost elements associated with providing local service. It is reasonable to assume that those limitations would also apply to CLECs. More importantly, if CLECs like GCI want to be “credited” with their additional costs, they should be required to detail those costs the same way an ILEC must do. When the CETC certifies to the state and the FCC that it is using the support for the purpose for which it was intended, it should be required to justify the level of support it receives. At the same time the CETC should be compelled to substantiate that its loop costs meet the minimum cost threshold for high-cost loop support eligibility established by the FCC.

While most of the blame for allowing USF to be used as a regulatory crutch to prop up an otherwise inefficient competitor lies with the FCC, state commissions, including the RCA, could but have failed to prevent this misguided policy. Under Section 214(e) of the Communications Act of 1934, state commissions are responsible for designating competing carriers as eligible to receive USF. However, the Act provides that, “Before designating an additional eligible telecommunications carrier

⁷ See *Petition by GCI Communications Corp. d/b/a General Communication, Inc., and d/b/a GCI for Arbitration with PTI Communications of Alaska, Inc., under 47 U.S.C. §§251 and 252 for the Purpose of Instituting Local Competition*, *Petition by GCI Communications Corp. d/b/a General Communication, Inc., and d/b/a GCI for Arbitration with Telephone Utilities of Alaska, Inc., under 47 U.S.C. §§251 and 252 for the Purpose of Instituting Local Competition*, *Petition by GCI Communications Corp. d/b/a General Communication, Inc., and d/b/a GCI for Arbitration with Telephone Utilities of the Northland, Inc., under 47 U.S.C. §§251 and 252 for the Purpose of Instituting Local Competition*, Docket No. U-99-141, Order No. 9 (Regulatory Comm'n of Alaska 2000).

⁸ In Fairbanks, ACS has a post-USF cost of approximately \$23.50. GCI, on the other hand, will have a post-USF cost of approximately \$9.00. This is not a competitively neutral result and it should be no surprise that GCI can offer its services at a lower price when it has a significantly lower cost of goods sold than ACS strictly as a result of regulatory decisions.

⁹ ACS acknowledges the Joint Statement of the Independent Telephone & Telecommunications Alliance, the National Rural Telecom Association, the National Telecommunications Cooperative Association, the Organization for the Promotion and Advancement of Small Telecommunications Companies and the Western Alliance. ACS believes that the entire question of the designation of wireless providers as CETCs needs to be closely examined. However, in those instances where CETC designation is genuinely in the public interest, ACS believes that the wireless provider's own costs must form the basis for any support eligibility and actual high cost support received.

for an area served by a rural telephone company, the State commission *shall find that the designation is in the public interest.*"¹⁰ (emphasis added.)

In the Fairbanks case, the Alaska commission conducted no such analysis and offered no basis, in the record or otherwise, to support an affirmative public interest finding. Rather, reflecting a profound misunderstanding of the issues, the RCA summarily concluded:

We found no evidence that GCI plans to use 2002 Federal Universal Service Funds in an inappropriate matter [sic]. We also note that GCI's local rates in competitive areas remain comparable to or lower than the incumbents', further suggesting 2002 Federal funds will be used appropriately.¹¹

This failure to conduct a factual investigation and reach conclusions based on a factual record prevents the FCC or the RCA from knowing anything about how this funding is being utilized. Congress should take steps to ensure that states carefully determine whether USF support is in fact being used for the purposes for which it was intended. This measured evaluation should apply equally to all CETCs.

Improper UNE Rates Compound the USF Dilemma

As is true with almost everything associated with implementation of the Telecommunications Act of 1996, no one issue stands alone. In this congressional hearing the focus has been on the specific operations of the Universal Service Fund. In its testimony, ACS has pointed out anomalies with CETC eligibility for support and the improper use of USF dollars. But, there is more.

While unquestionably important, USF is but one revenue stream that joins others to contribute to the overall financial health of the telecommunications industry. In turn, a healthy industry is able to offer more and better services and hold rates at affordable levels. It was Congress' intent that USF contribute to that end. But, we must remember that other revenue streams also make important contributions. One source of revenue that has failed to achieve universal service objectives is that derived from the sale of unbundled network elements or UNEs. The most consequential UNE is the "loop" or the connection that directly ties the customer's home or office to the rest of the phone network.

Beyond offering a facilities-based opportunity for competitors to enter local markets, UNE prices are also supposed to fairly compensate incumbents for the use of their networks. These rates should send proper economic signals to both incumbents and new competitors to prompt new infrastructure investment. These rates should also be set at levels that ensure that the Carrier of Last Resort, typically the ILEC, has the financial resources necessary to ensure that the network continues to meet established universal service standards for safe, reliable and affordable basic telecommunications services.

In addition to redirecting USF support away from meeting Carrier of Last Resort obligations, the situation in Alaska has been substantially exacerbated by the State commission's approval of unconscionably low UNE prices. ACS' experience in the Fairbanks market is a case in point. As previously noted, the cost to ACS of providing a loop in Fairbanks is approximately \$33.50. However, the RCA has deemed it reasonable to set the UNE loop price at \$19.19. When ACS is forced to lease its loops under the state commission's pricing scheme, it immediately loses much more than the \$14.30 difference between ACS' cost and the price paid by the competitor. It also loses all of the retail revenue associated with that line, along with the access revenue previously received from long distance carriers for use of the local network. And, as already noted, it loses the USF support related to that line. The end result is that ACS, with ongoing responsibility as Carrier of Last Resort, must approach its universal service obligations with only one-third of the revenue it previously had available prior to losing the access line to a competitor.¹²

While low UNE rates may have prompted market entry—in some cases, uneconomic market entry—they clearly do not fairly compensate the owner of these facilities nor will they incent any industry participant to invest. In the final analysis, the aggregate loss of these revenue streams will, over time, make it impossible for the incumbent to continue to provide reliable and affordable service—the very essence of the universal service definition.

¹⁰Section 214(e)(2) of the Communications Act of 1934, as amended by the Telecommunications Act of 1996.

¹¹RCA Order U-01-90(2) dated November 13, 2001 at 6.

¹²ACS estimates that, prior to the onset of local competition, its average revenue per line in Fairbanks from all sources was approximately \$726 annually. With the termination of the rural exemption and competitive entry based on leasing UNE loops at state arbitrated rates, ACS' average annual revenue per line drops to approximately \$230.

Improper Termination of “Rural Exemption” Prompts the USF Dilemma

In addition to the “UNE factor” just discussed, the state regulator’s improper termination of the congressionally mandated “rural exemption” has also severely and negatively impacted the goals of universal service in Alaska.

As Congress is well aware, the express language of the Act specifically creates a mechanism to protect the fragile universal service balance that has been struck in America’s rural markets. The Telecom Act confers upon rural customers and the companies that serve them an exemption from certain interconnection obligations unless it can be demonstrated that it would be in the public interest to terminate or otherwise alter those obligations. State commissions have generally been tasked with the responsibility to find that terminating this exemption will not impose undue economic burdens on the incumbent carrier or otherwise do harm to the goals of universal service.

To date, the RCA has been asked to terminate the “rural exemption” in several Alaska communities, including some communities of less than 1,000 people such as Seldovia, Ninilchik, North Pole and Delta Junction. In every instance, with virtually no factual basis to sustain its findings, the RCA has granted the petitions filed by competitors and has terminated the Federal protections you thought you had authorized in the Act. Clearly the balance Congress sought to strike between the advent of local competition and the preservation of universal service goals in rural America has been lost in practice as witnessed by the Alaska experience.

Implications for Congressional Policy

The combined effect of the improper termination of the “rural exemption,” the state commission’s desire to price UNE loops at the lowest possible levels, and the shifting of scarce USF support to a competitor that does not even have high cost facilities has placed tremendous pressure on ACS’ ability to assure universal service to the consuming public. Perhaps the RBOCs are big enough and sufficiently entrenched that these types of policies can be applied to them without threatening their survival, but ACS is a small independent carrier and cannot withstand this type of assault on its business.¹³ Just last month, Goldman Sachs noted, “ALSK [ACS] actually faces the most severe competition in the country evidenced by its low 50 percent market share in Anchorage, mid-70 percent market share in Fairbanks, and mid-80 percent market share in Juneau.”¹⁴

Federal policies that encourage our customers to move to competing carriers on the basis of artificially low UNE-based cost structures is a recipe for disaster. To put it simply, ACS cannot not continue to invest in the provisioning, maintenance and upgrading of facilities if it cannot achieve a fair return on its investments. Likewise, our competitors will not invest in facilities-based service—the ultimate goal of the Telecommunications Act of 1996, when they can acquire access to facilities less expensively from ACS than it would cost to build out the network themselves.

Congress must be concerned that its legislative intent is being ignored or misdirected. ACS is prepared to suggest fair and impartial remedies.

1) Although many of us believe Congress clearly intended USF subsidies to flow only to those carriers with unusually high costs, the FCC apparently didn’t get the message. Congress can fix this problem by enacting legislation clarifying that all carriers, not just incumbent carriers, must justify their need for subsidies with data demonstrating their costs. Congress must also ensure that subsidies flow only to those carriers with unusually high costs. This would not prevent competition based on price, but would ensure that the USF subsidy flows to the competitor which actually incurs the high cost.

2) To adequately protect its goal of providing universal service to consumers in high cost and rural areas, Congress must tighten the laws that currently give State commissions wide discretion to terminate the unbundling exemption—the “rural exemption.” These decisions are just as much a threat to universal service as are limitations on the flow of USF subsidies.

¹³In December 2002, Legg Mason commented that, “. . . better future results for ALSK (ACS) hinge on improvement to the regulatory landscape . . . ALSK cannot be meaningfully compared to its RLEC (RBOC) peers . . .”

¹⁴In January of this year, Standard and Poor’s Rating Service lowered its corporate credit rating on Alaska Communications Service Group, Inc. to BB- from BB. S&P noted, “ACS’ business risk profile has declined as the company has lost local retail access lines to competition that has taken advantage of low unbundled network element UNE loop rates.” Also in January 2003, Raymond James and Associates reported that, “GCI has taken 60,500 lines, primarily on a UNE basis. The ACS UNE rate of \$14.92 seems low . . . this has put a significant burden on the operations of ACS, . . .”

3) Congress should clarify that the burden of proof for terminating a rural exemption is on the competing carrier—a view adopted by the Federal courts and the FCC but misunderstood and rejected by the Alaska commission and potentially by other states.

4) In addition, Congress should clarify that the goals of universal service will not be compromised solely to open the doors to competition. It is difficult to understand how competition can benefit consumers in markets where there would be no service at all but for the significant flow of Federal subsidies. In that regard, Congress should instruct the states that the statutory “rural exemption” should be terminated only in unusual circumstances and where CLEC applicants have put forth a clear and convincing case that the public interest will not be harmed.

5) Finally, Congress should put an end to the all-to-common state practice of denying incumbent carriers their costs when setting UNE rates. This practice, particularly when applied to rural carriers that have had their rural exemption terminated, significantly compromises universal service. ACS does not think this practice was intended by Congress, but both the statute and the FCC rules are sufficiently vague to allow for this interpretation. Consequently, ACS strongly urges Congress to enact legislation making it clear that Carrier of Last Resort must be fairly compensated when leasing its facilities to competing carriers.

Conclusion

ACS joins the other witnesses in expressing its concern for the ongoing health and viability of the Universal Service Fund. While only one of several revenue streams contributing to the preservation of basic affordable telephone service, USF remains a critical element in the equation. If the issues described in this presentation remain unresolved, the Fund will soon spin out of control. At that point, policymakers will have no other choice but to substantially expand the base of contributors and increase the amount of the contributions. Doing so will not only have a direct impact on individual consumers, but will also add unexpected burdens on the deployment of new technologies. Congress must act soon to minimize the negative effects that are likely to occur in the absence of near term action.

Thank you for this opportunity to raise our concerns. I would be happy to answer any questions you might have.

Senator BURNS. I said “Dana,” it is probably “Danna,” is it not?
Ms. TINDALL. No, it is “Dana.”

Senator BURNS. “Dana”? Oh, son of a gun. Senior Vice President for General Communications, Inc., out of Anchorage, Alaska, and thank you for coming down today. We appreciate that very much.

STATEMENT OF DANA L. TINDALL, SENIOR VICE PRESIDENT, LEGAL, REGULATORY, AND GOVERNMENTAL AFFAIRS, GENERAL COMMUNICATION, INC.

Ms. TINDALL. Good morning. Thank you for inviting me to be here today.

As the largest wireline competitive ETC in the country, I believe GCI has a unique perspective to offer you. GCI provides competitive telecommunication and cable service to over 220 communities in Alaska. We have the largest market share for facilities-based long distance. Our cable network passes 95 percent of the homes in Alaska. We offer cable modem service to 90 percent of those homes. In our most rural markets, we have begun providing high-speed Internet services at urban rates. It is our plan to provide high-speed service to every rural community we serve by year-end 2004, without subsidy.

According to NTIA, Alaska is the second-most wired State in the country. GCI began offering competitive local telephone service in Anchorage in 1997. After a lengthy battle to terminate rural exemptions, we rolled out service to Fairbanks and Juneau in 2002. Today, we have a market share close to 45 percent in Anchorage, 21 percent in Fairbanks, and 19 percent in Juneau.

Since 1996, GCI has invested over \$530 million in its telecommunications network. We have our own switching and transport facilities. Currently, we lease the copper loop from the incumbent. However, we are in the process of testing a cable telephony platform in Anchorage and plan to begin converting up to a thousand homes per month starting in 2004. It is our goal to eventually provide local services on our own network wherever feasible throughout the State of Alaska.

So why are Universal Service Fund's costs spiraling ever upward? By far and away, high-cost funding is the largest portion of overall universal service cost, at 52 percent. Of that, incumbents account for 96 percent of high-cost funds while CETCs account for only 4 percent.

High-cost support is increasing for two primary reasons. One, high-cost funds to incumbents and CETCs, alike, are based on incumbents' self-reported costs. Two, incumbent carriers experience no meaningful incentives to reduce cost, even in the face of competition.

As implemented today, an incumbent telephone company receives funding on the basis of its costs. If it loses a customer to a competitive carrier, it does not lose high-cost funding for that customer. Not only is the cost for funding being driven up because both the incumbent and the CETC are receiving funds for the same customer, but the incumbent is experiencing no incentive to reduce costs in the face of competition. It is still getting paid. If you want to reduce the need for funding, you must change the incentive structure.

Schools and libraries make up 35 percent of total high-cost funding. And in contrast to loop funds, subsidies per user are actually decreasing for the same service. This is true for three reasons. One, it is a voucher program with subsidies to the end user, making it inherently more efficient. Two, the end user must have a plan ensuring that he or she will actually use the funds for what they are designed for. And three, service is competitively bid. The lowest-cost service provider must be selected.

So what can we do? To control the growth in demand for Universal Service Funding, we can, one, cap the support for a given study area upon the entrance of a competitor; two, step down per-line subsidies over time; three, make subsidies truly portable by eliminating double-dipping; four, restrict support to the primary line irrespective of the technology used to provide that service; five, consolidate study areas in a State so that an incumbent cannot game the system by creating high-cost areas through separate study areas.

Our proposals to expand the contribution base are, one, require all interstate communications providers to contribute, including providers that offer comparable competitive services, such as cable modem providers; two, assess contributions for bandwidth usage as a connection fee to all interstate users on a competitively and technologically neutral basis.

Alaska is the home of some of the most competitive markets in the country. We are proud of what we have accomplished. And it was competition and universal service working hand in hand that brought us here. Competition is essential to universal service as it

drives down costs and decreases demand for subsidies. Both policy tools are necessary for the continuation of basic and advanced communications services throughout our country.

Thank you very much.

[The prepared statement of Ms. Tindall follows:]

PREPARED STATEMENT OF DANA L. TINDALL, SENIOR VICE PRESIDENT, LEGAL,
REGULATORY AND GOVERNMENTAL AFFAIRS, GENERAL COMMUNICATION, INC.

Introduction

Good morning. My name is Dana Tindall, and I am the Senior Vice President, Legal, Regulatory and Government Affairs for General Communication, Inc. ("GCI"). I appreciate this opportunity to appear before the Senate Commerce Committee and the Communications Subcommittee to share GCI's perspective on how to ensure the sustainability of the Universal Service Fund in the face of significant growth in demand and reduction in the contribution base.

In Alaska, the home of the most competitive markets in the country, we are at the forefront of these national issues and offer our experiences as a window into the near future for other developing competitive markets throughout the country. GCI believes that the Universal Service Fund is an essential component of national telecommunications policy, and the focus should remain on improving service to consumers, not on particular carriers. GCI also believes that competition will further the goals of universal service, by enhancing efficiency and encouraging the development and deployment of new services in high-cost areas. As is now evident, without competition to discipline carriers and incent them to provide service in a cost-effective manner, the Universal Service Fund cost structure will grow so large that it may become impossible to sustain.

Today, I will share with you GCI's experiences as a competitive eligible telecommunications carrier ("CETC") that serves all customers—residential and business—competes to serve all lines, especially primary lines, and provides widespread advanced broadband services. Our experiences suggest a roadmap for national policy on universal service and shows that competition and universal service go hand-in-hand in delivering the maximum benefit for rural consumers. Indeed, competition is the most effective tool policymakers have to ensure that universal service support flows where it is truly needed and in the appropriate amount, regardless of the size of the market. It is a real mistake to try to determine in advance whether a particular market is "too small" for competition. Incumbents will always say their markets are "too small," ignoring that consumers win when they have a choice of providers. Universal services at affordable rates that are reasonably comparable in rural areas to urban rates are best and most efficiently preserved and enhanced through competition, not monopoly.

This principle equally applies to the administration of the Universal Service Fund itself. Demands on the high cost fund have grown significantly over the past several years, as incumbents' expectation for full recovery of embedded cost plus a rate of return has gone virtually unchecked. At the same time, the contribution pool, from which this growing demand must be met, has diminished. GCI proposes the following recommendations for a carrier-neutral universal service program that is focused on protecting and enhancing service in high-cost areas in a cost-effective manner:

Curbing Demand on the High Cost Fund

1. Restrict support to the customer's primary line.
2. Cap the per-line support for a study area upon the entrant of a competitor.
3. Make support truly portable.
4. Step down per line subsidies when a market can be served at a lower cost.
5. Consolidate study areas within a state for USF support purposes.
6. Define "affordable rates."

Expanding the USF Contribution Base

1. Expand the contribution base beyond telecommunications providers.
2. Assess a connections-based fee.

These recommendations offer real solutions to the issues facing the Fund. Disadvantaging competitors or prohibiting competitive entry is not a real solution to Universal Service Fund issues, and would only deny consumers in rural America the quantifiable benefits of competition.

GCI's Service Offerings

GCI provides competitive telecommunications and cable service to more than 200 communities in Alaska, and over the past five years alone, GCI has invested over \$365 million in a facilities-based network throughout Alaska. In 1982, we first entered the Alaska market as a long distance provider. Today, GCI has the largest market share of any long distance provider in Alaska, even though we are prohibited by Federal regulation from building our own facilities to provide long distance service to some 150 bush villages.¹ And consumers have benefited from competition. In 1983, 83.8 percent of Alaskan homes had telephones, the second lowest rate in the country. With the introduction of long distance competition, service quality and availability began to increase as rates decreased. By March of 2002, telephone penetration had reached 96.4 percent, and in all but one year since 1996, Alaska's rate of household penetration has exceeded the national average. In addition, before the introduction of intrastate long distance competition in 1991, a ten-minute call from Anchorage to Juneau cost \$9.25. Now, as a result of competition, the same call would cost \$1.40. The Alaska experience demonstrates that universal service and competition are an essential partnership.

GCI began buying cable properties in 1996. Today, our cable network passes 95 percent of the homes in Alaska. We offer broadband cable modem service to approximately 90 percent of Alaskan homes, and we provide 62 percent of Alaska's dial-up Internet access. Alaska is the second most wired state in the country,² and Alaskans use the Internet more than any other state in the Nation on a per capita basis.³ These vital connections are not only available in our cities. GCI is working to deliver high-speed broadband Internet services throughout the smallest villages of Alaska, and we now offer high-speed wireless Internet at affordable prices to 12 villages and through DSL to five more villages,⁴ located in some of the most rural parts of Alaska. For example: Akutan is a village located on Akutan Island in the eastern Aleutians and has a population of 713. Fifty percent of households in Akutan have subscribed to our high-speed Internet offering. We are scheduled to offer high speed Internet service to every village and community where we have a point of presence by the end of 2004. In both urban and rural areas, GCI is delivering on the advanced services deployment that Congress expected when it passed the Telecommunications Act of 1996.

GCI entered the competitive local exchange business in Anchorage in 1997, and now serves over 40 percent of Anchorage residential and business customers combined. Since that time, consumers in Anchorage have saved approximately \$15 million on local service rates. But GCI was blocked for over four years from bringing these same benefits to Alaska's second and third largest cities, Fairbanks and Juneau, by incumbent carrier claims that these areas were "too small" to permit competition. They were wrong. After an extensive and costly battle to terminate rural exemptions that prevented GCI from leasing incumbent local exchange carrier ("ILEC") unbundled loops to connect to GCI's switches, we began offering service to Fairbanks in 2001 and to Juneau in 2002. Customers have responded positively to GCI's entry in these markets, and GCI now serves over 21 percent of the Fairbanks market and over 14 percent of the Juneau market. As a designated eligible telecommunications carrier ("ETC"), GCI receives universal service support based on the incumbent's costs. Because GCI receives support on a per-line basis, rather than an overall cost basis like the incumbent, GCI funds its up-front investments of undertaking to serve the market. In 2003, GCI is projected to receive \$473,229 in high cost support, and the incumbent is projected to receive over \$27 million in high cost

¹See *Policies Governing the Ownership and Operation of Domestic Satellite Earth Stations in the Bush Communities in Alaska, Tentative Decision*, 92 FCC 2d 736 (1982); *Final Decision*, 96 FCC 2d 522 (1984).

²U.S. Department of Commerce: Economics and Statistics Administration and National Telecommunications and Information Administration, "Falling Through the Net: Toward Digital Inclusion," Table 1-B, Percent of Households with Internet Access, By State: 2000 (Oct. 2000) at 22.

³U.S. Department of Commerce: Economics and Statistics Administration and National Telecommunications and Information Administration, "A Nation Online: How Americans Are Expanding their Use of the Internet," Table 1-1, Internet Use by Percent of State Population (Feb. 2002) at 8.

⁴These services are offered in conjunction with the local exchange carrier serving the village.

support.⁵ Despite the incumbent's claims that competition will bring "financial disaster,"⁶ its local telephone revenues continue to grow.⁷

GCI has installed its own switch and fiber transport facilities in each of the communities it serves. GCI serves the majority of its local residential and business customers using UNE loops. GCI is proud of its distinction as serving the most competitive markets in the Nation, making Alaska a leader in the telecommunications revolution.

Although GCI can deliver its products using UNEs, the company is also making substantial investments in its own loop facilities to free us and our customers to the extent possible from the ILEC monopoly in these markets. GCI has placed great emphasis on the next stage of facilities-based competition, cable telephony deployment. GCI's engineers have designed an industry standard platform to connect the cable system to our local telephone network. We plan to begin converting customers to our cable telephony network at a rate of up to 1,000 homes per month starting next year. We have set a goal to convert all local customers that can be reached via the cable telephony network, and we have embarked on a plan to reach that goal.

Stated simply, competition delivers. It has resulted in the deployment of improved technologies, the introduction of new service offerings, and the delivery of lower rates to consumers, without any credible threat to the core supported services. Maintaining universal service is a priority of the highest order, and increasing demands on the Fund is an issue that must be squarely addressed. We believe that competition is essential to achieving the goals of the Universal Service Fund, which cannot be sustained if permitted to continue to grow without any discipline on costs. Every carrier must strive to be cost efficient, which is simply not likely unless demands for full, perpetual recovery of self-reported costs are not kept in check by competition.

An Assessment of the Major Components of the Universal Service Fund

Incumbents and competitors alike agree that the increasing demand on USF over the last several years is an important issue that must be addressed to ensure that the Fund is sustainable over time. Contrary to the claims of some, however, payment of universal service to competitive ETCs is not the primary, or even secondary, source of the increase in demand. This simplistic view fails to see the importance of competition for protecting the Universal Service Fund. GCI urges the members of the Committee to look at these claims with a critical eye.

The two major components of the Universal Service Fund are High Cost Support and the Schools and Libraries Program. High Cost Support constitutes over 52 percent of the total fund, while the Schools and Libraries Program constitutes over 35 percent (with the Rural Health Care Program constituting less than 1 percent).⁸ In the case of High Cost Support, guaranteed recovery of ILEC costs plus a rate of return has resulted in ever skyrocketing demand; in contrast, competitive bidding and a cap on the Schools and Libraries fund have imposed disciplines on spending for this program, while ensuring delivery of a quality product. The comparison of these two programs is instructive for considering Universal Service Fund reform.

High Cost Support

In 1999, incumbents received \$1.7 billion in High Cost Support. Just four years later, incumbents are projected to receive \$3.2 billion, almost twice that amount. At the same time, competitive ETCs are projected to receive only \$106.5 million in High Cost Support this year, *less than four percent of all High Cost Support. It is not the entry of competitors that has produced any profound increase on the Fund, but rather, the Fund has expanded to accommodate guaranteed revenue requirements including a rate of return for incumbent carriers as described below.*

The largest increase in High Cost Support over the last four years resulted from the removal of implicit subsidies from access charges, to be recovered from the Fund. In two proceedings, the FCC identified what it considered to be implicit subsidies, first in price cap access charges and then in rate-of-return access charges. Moving these subsidies to USF made them explicit, rather than implicit, as Con-

⁵ Universal Service Administrative Company, "Federal Universal Service Support Mechanisms Fund Size Projections for the Second Quarter 2003" (Jan. 31, 2003) (projections based on 2Q 2003 data provided in Appendix HC01).

⁶ Alaska Communications Systems Group, Inc., Form 10-K, filed for the Year ended December 31, 2002 at 33 (summarizing local telephone operating revenues for 2000, 2001, and 2002).

⁷ Letter from Karen Brinkmann, Latham & Watkins, LLP, Counsel for ACS, to Secretary, Federal Communications Commission, CC Docket Nos. 01-338, 96-98, 98-147 (filed Jan. 6, 2003) at 11.

⁸ The Low-Income Fund constitutes the balance of the Fund (11.7 percent).

gress directed in Section 254(e), but it also resulted in significant increases in high cost support. The FCC created two new funds to make these subsidies explicit. Subsidies have been made available to price cap carriers since 2000 through the Interstate Access Support Fund, and the projected 2003 demand is \$650 million, the full capped amount. Similar subsidies have been made available to rate-of-return carriers through the Interstate Common Line Support Fund, and the projected 2003 demand is \$383 million. These access charge reform mechanisms constitute over 30 percent of the total high cost fund amount. And competitive carriers receive *less than four percent* of this support.

At the same time, other high cost fund components have increased steadily over the past several years. From 1999 to 2003, High-Cost Loop Support has grown by 22 percent, Long Term Support has grown by almost 7 percent, Local Switching Support has grown by 12 percent, and since 2000, High-Cost Model Support has grown by 6 percent. And because all support, other than High-Cost Model Support, is calculated based on the ILEC's embedded costs plus a rate of return, the continued increase in fund demand—which far outpaces the rate of inflation—demonstrates that guaranteed cost recovery to incumbents has not provided any incentive to reduce costs. To the contrary, for rate-of-return carriers, the incentive is just the opposite, to maximize cost as a means of maximizing guaranteed return. Higher costs yield higher dollar returns and more subsidies.

It is important to realize that, with respect to the four types of universal service support received by rural telephone companies regulated under rate-of-return regulation, the incumbent receives the same amount of universal service support for a given service territory no matter how many customers it serves in that area. *Competitive entry has no impact on the incumbent's total level of support, even when the competitor takes customers using all of the competitor's own facilities.* High cost support is paid to incumbent rural areas based on embedded costs. Because ILECs are paid based on total costs, *not based on the number of lines served*, the subsidy paid to the ILEC does not change even when it loses customers to the competitor. Therefore, when GCI serves a customer with an unbundled loop leased from the ILEC, it not only receives the lease rate from GCI but also continues to receive the same amount of USF support that it received when it served the customer. In this way, USF pays the incumbent an additional amount beyond the lease rates paid by the CLEC for the ILEC to sit idle. Competitors receive no such payment. If the Fund is skewed, it is skewed in favor of incumbents, which have no incentive to reduce costs when even the loss of customers does not affect its universal service payments.

Schools and Libraries and Rural Health Care Programs

In contrast, cost reduction incentives have been employed in the Schools and Libraries and Rural Health Care Programs. In our opinion, these programs have been largely successful for three reasons. First, the programs essentially work as a voucher to the eligible school, library, or rural health care provider to use with the provider of its choice. Providing support directly to the end user, rather than to the service provider, is inherently more efficient than delivering support to service providers. Second, the school, library, or rural health care provider must have a defined need and plan for the services to ensure that the support is directed to meet the identified service needs. Finally, competitive bidding reduces the cost of individual contracts. Schools, libraries, and rural health care providers are required to select the most cost-effective bidder, with price being the most important criteria in making the assessment. GCI began participating in these programs virtually at their inception. GCI has invested in technology that reduced the cost per unit of bandwidth delivered over satellite by over 80 percent since 1999. As compared to the high cost fund, per customer subsidies from the Fund are actually declining for the same services, increasing the utility and reach of fund disbursements.

Moreover, these funds produce identifiable results. GCI delivers high-speed Internet to 295 schools across all reaches of the state, providing broadband Internet access to 80,000 school-age children. In 1997, only two of Alaska's 53 school districts had access to the Internet. Today, 99 percent of Alaska's schools have Internet access. GCI also provides services to schools and libraries on a more limited scope to Arizona, Montana, and New Mexico. In addition, GCI is providing broadband services to over 90 rural health clinics, bandwidth that brings technological diagnostic advances to some of the most isolated villages in America.⁹

We understand there have been reported instances of fund misuse and misdealing; however, we expect that any such abuses can be reduced or eliminated through tighter audit and control procedures. In addition, to the extent that recent shifts in funding away from rural areas have been identified, such shifts can be cor-

⁹ GCI is also serving five regional hospitals and two Veterans Administration medical centers.

rected as needed by adjusting the criteria for discounts. Based on our experiences in Alaska, however, these programs are working well, providing crucial services to the areas intended when the programs were initially conceived.

The comparison of these funds demonstrates that universal service and competition go hand in hand. Competition ensures that services are delivered to consumers in the most efficient manner at the lowest price. In those cases when the lowest unsubsidized price is still too high to keep rates affordable and reasonably comparable between urban and rural areas, universal service—if constructed correctly—should provide targeted subsidies to bring those prices down to the identified affordable and reasonably comparable levels. Increasing demands on the Fund is an issue that must be squarely addressed, and competition is a key element of the solution for preserving universal service in the long term. Experience tells us that the absence of competition will only ensure that there is no discipline on ILEC costs or their demands for full, perpetual recovery of those self-reported costs.

Real Solutions

Curbing High Cost Fund Demand

This overview of where the real growth in the USF fund lies underscores that USF policies simply have not kept pace with the development of competition. Competitive entry should discipline costs and encourage carrier efficiency. However, under current policies, ILECs can avoid the realities and delay the benefits of a competitive market by recovering their full embedded costs through the USF fund. With this continued dependence on guaranteed recovery and returns, ILECs have criticized the presence of competition without offering any real solutions to the issues facing universal service.¹⁰ While solutions may not be simple, it is clear that adopting the competitively skewed framework advocated by some will not discipline incumbent costs and will deny the promise of competition to many rural areas of the country.

Based on these principles developed through our experience as a facilities-based competitor, GCI offers the following recommendations to curb demand on the High Cost Fund:

1. Restrict support to the customer's primary line. The Universal Service Joint Board recommended that support be available for a single connection per principal residence, but the FCC did not adopt it and deferred consideration of the proposal.¹¹ GCI recognizes that there are practical limitations in implementing this proposal in a competitively neutral manner that must be resolved and urges industry collaboration to develop a workable solution. Successful implementation would eliminate additional support amounts to individual households; support would be available only for a single designated connection, without any bias toward any particular technology or carrier.

2. Cap the per-line support for a study area for both the ILEC and the CETC upon the entrant of a competitor. The Rural Task Force, with the agreement of the rural carrier community, proposed such a cap to the FCC, but it was not adopted.¹² The ability to discipline costs and efficiency through competition should not be impeded by perpetual guaranteed cost recovery through USF.

3. Make support truly portable. Today, incumbents do not lose any USF support upon competitive entry. Because support to incumbents is paid based on total costs and not based on the number of lines served, the subsidy paid to an incumbent does not change even when that incumbent loses customers to a competitive carrier. If the customer's chosen carrier receives support for providing a line, another provider should not also receive support for the same line. As long as ILECs are permitted to receive support where they have no customer, they will not experience any incentives to control cost, and the demand for USF support will continue to spiral upwards.

4. Step down per line subsidies. All providers, especially those that are inefficient (or less efficient), should be subject to market discipline, even if subsidies are necessary to maintain affordable rates. If an ETC can serve the market at a lower price, per line support to that market should be decreased accordingly.

¹⁰ See Attachment 1, "Competitively Neutral Universal Service Policies Must Be Preserved."

¹¹ See *Federal-State Joint Board on Universal Service, First Report and Order*, 12 FCC Rcd 8776, 8829–30 (1997); *Federal-State Joint Board on Universal Service, Recommended Decision*, 12 FCC Rcd 87, 132–33 (1996).

¹² *Federal-State Joint Board on Universal Service, Recommended Decision*, 16 FCC Rcd 6153, 6161 (Jt Bd 2000); *Federal-State Joint Board on Universal Service, Fourteenth Report and Order, Twenty-Second Order on Reconsideration, and Further Notice of Proposed Rulemaking in CC Docket No. 96–45, and Report and Order in CC Docket No. 00–256*, 16 FCC Rcd 11244, 11325–27 (2001), recon. pending.

5. Consolidate study areas within a state for USF support purposes. Today, carriers serving “rural” study areas that have non-rural characteristics and density receive support based on embedded costs, even when that carrier (or commonly owned carrier) also serves non-rural study areas. Companies who bought separate properties are able to game the system by maintaining multiple study areas in the same state under common ownership, even though they benefit from their statewide economies of scale. Universal service support should be determined for these carriers based on statewide operations and line counts.

6. “Affordable rates” must be defined. USF should not subsidize comparably lower rates unless the provider can demonstrate that rates must be kept at that level in order to be affordable and reasonably comparable.

These solutions are each aimed at disciplining and reducing incumbent costs—the costs on which high cost support is calculated—and thus, directly address the threat of uncontrolled escalation.

Expanding the USF Contribution Base

Addressing fund demand only reaches one side of the issue. The other issue to be addressed is the declining contribution base. There has been considerable debate before the FCC concerning changing the manner in which carrier contributions to USF are assessed. On this matter, GCI offers the following proposals to ensure that an appropriately sized USF is fully funded:

1. Expand the contribution base. The contribution base should be expanded to ensure that all beneficiaries of the network contribute to universal service and that contributors are not competitively disadvantaged *vis-à-vis* other providers of functionally equivalent facilities-based services by inequitable or discriminatory contribution requirements. Expanding the contribution base may require amending Section 254(d), which currently limits contributions to “telecommunications carriers,” or may require a public interest finding by the FCC extending contribution requirements to other providers of interstate telecommunications. For example, the term “telecommunications carriers” includes DSL providers but does not require contribution by cable modem providers, which do not provide telecommunications to end users, but which use telecommunications to provide cable modem service to end users.

2. Assess a connections-based fee. Contributions to the Fund should be based on a per-connection fee (which could include telephone numbers-based proposals).¹³ This approach should ensure competitive neutrality, in that one technology is not favored over another.

The Future of Universal Service and Competition

GCI is moving steadily toward fulfillment of its plans to deploy full facilities-based competition through cable telephony. GCI is now testing IP-based cable telephony and has commenced service trials that will continue over the next several months. Cable telephony deployment will enable GCI to reach the majority of its local service customers entirely over its own facilities, and the ILEC has given GCI every incentive—from discrimination of its customers to seeking unprecedented relief from UNE loop unbundling obligations—to do so. The competitively neutral universal service policy in place today is the right approach, and it is the only approach that makes sense in a market where two facilities-based carriers provide functionally the same service.

GCI believes that its continued strides toward full facilities-based competition is just the type of competitive evolution that Congress expected when it passed the Telecommunications Act of 1996.¹⁴ Indeed, facilities-based competition is the very mechanism that will discipline universal service demand by reducing over time the make-whole subsidy that ILECs in competitive markets still expect to receive. In this regard, the competitive advancements in the Alaska market serve as a blueprint for the Nation and underscore that competition and universal service work in tandem to satisfy the goals of the Act. Competitively neutral universal service policies are essential to ensuring the development and delivery of services that are reasonable comparable in price and quality throughout all regions. Thus, the continued availability of universal service on a competitively neutral basis will ensure both the sustainability of the Fund and that the benefits of competition will be available for all consumers.

Thank you for the opportunity to present GCI's views on this important issue.

¹³ For those providers that do not connect with the public switched telephone network but are required to contribute to USF, a suitable proxy for the connections-based fee should be applied.

¹⁴ See Attachment 2, “GCI Proposal for Shared COLR and Pricing Flexibility in Competitive Local Markets.”

Competitively Neutral Universal Service Policies Must Be Preserved

The FCC requires that competitive eligible telecommunications carriers (“CETCs”) are entitled to universal service high cost support on a per-line basis based on the incumbent local exchange carrier (“ILEC”) costs, up to the UNE price. This is a competitively neutral approach for issuing universal service to competitive carriers, consistent with the goals and purposes of the Act. It is clear that a level playing field can only be maintained if ILECs and CETCs have access to universal service support in the same amount for the same quality service. ILECs as a group, however, have attempted to tilt the playing field in their direction by seeking to deny USF support to CETCs.

ACS, the Alaska ILEC, has raised similar arguments. ACS has claimed that CETC loop costs, measured by UNE rates, should be used to determine CETC high cost loop support. According to ACS, its monthly loop costs for Fairbanks are \$33, and GCI’s are \$19.19, the UNE loop rate. Because high-cost loop support is paid for costs in excess of \$23 per month, ACS claims that GCI should receive no support for its Fairbanks customers. The FCC previously rejected the basis for ACS’ discriminatory proposal in implementing Section 254 in order not to discourage competition in high cost areas, and ACS’ latest efforts to change this policy must likewise be rejected.

Using CETC costs as a separate basis for CETC high cost loop support would undermine positive competitive pressures. Calculating CETC support based on CETC costs while subsidizing the ILEC based on its embedded costs eliminates incentives to control costs and rewards inefficiency by giving the CETC the same inappropriate incentive to inflate costs that has existed for ILECs under rate base/rate-of-return regulation. If a CETC simply loses USF support when it cuts costs through efficiencies, the CETC has no incentive to implement such measures. Even worse, the system championed by ACS would destroy the appropriate price signals that drive competition and force competitors—CETCs and ILECs, alike—to strive to deliver the highest value product at the lowest price. In the end, the ACS plan would have American consumers—who ultimately pay for universal service—forego the opportunity for higher quality and lower priced service by disadvantaging competitive service, particularly in rural areas.

Issuing support on differing cost bases would disrupt the competitive market environment. A high-cost subsidy should not eliminate the healthy competitive battle to reduce costs and be the most efficient provider. An essential element of any competitively neutral universal service support system is that support payments in the same market for the same service not differ based on the identity of the carrier providing the service. Further, under a system of uneven support where the ILEC is paid more than the CETC in the same market, the CETC would be required not only to be more efficient than the ILEC’s costs, but also the ILEC’s costs as reduced by the subsidy. This approach would tip the competitive balance in favor of the ILEC, while the current system maintains the competitive balance.

ACS has mischaracterized GCI’s loop costs. ACS’ claim that GCI’s loop cost consists solely of the \$19.19 monthly UNE loop rate is not accurate. A CETC’s costs do not consist solely of the price paid for ILEC UNE loops, even for those CETCs that rely extensively on UNE loops. For example: in Fairbanks, the ILEC UNE loop rate of \$19.19 per month comprises only a portion of GCI’s loop facilities and costs. GCI also provides facilities, including digital loop carriers, fiber terminals, DSX cross connects, cable and ducts. GCI estimates that these additional per line costs are more than \$11 per month. Using an “apples to apples” cost comparison, therefore, ACS’ reported loop costs is \$33 per month, and GCI’s is about \$30 per month. Moreover, GCI also provides service entirely with its own loops. ACS’ narrow focus on UNE loop rates ignores these other costs of facilities-based competition.

ILEC-reported embedded costs are not inherently “real” costs. ACS presents the embedded cost of a loop as carried on its regulatory books as “actual” costs, but these costs are not objective, unavoidable costs. These embedded book “costs” are a bookkeeping creation, grown out of years of State and Federal rate-making decisions and ILEC investments in a rate base rate-of-return environment that provides little incentive for cost discipline. For example, in July 2002, ACS reported its average loop cost in Fairbanks to be \$33.51, but just months later, in October 2002, that same loop cost was reported to be \$29.50. The ACS loop cost has been a moving target.

ATTACHMENT 2

GCI Proposal for Shared COLR and Pricing Flexibility in Competitive Local Markets

GCI currently serves over 40 percent of the local market in Anchorage, Alaska. ACS, the incumbent local exchange carrier (ILEC), retains a monopoly over the loops that serve virtually all the customers in Anchorage. In accordance with these market conditions, GCI has submitted the following proposal to the Regulatory Commission of Alaska to revise local market regulations:

Carrier of last resort responsibilities: A competitive local exchange carrier (CLEC) would be required to share in carrier of last resort (COLR) responsibilities when that competitor serves more than 35 percent of the market over its own facilities and/or with UNEs obtained from the incumbent. Sharing COLR responsibility in some cases may involve the CLEC contributing capital to the ILEC to extend facilities or extending facilities itself to unserved areas such as a new subdivision. In addition, to the extent a CLEC contributes to COLR responsibilities, it would receive corresponding discounts or credits on UNEs purchased from the ILEC. *This balanced approach toward shared carrier responsibilities demonstrates that the advancement of competition need not place with ILECs the sole obligation to bear COLR responsibilities.*

Reciprocal Unbundling: Once a CLEC is required to share COLR responsibilities, the CLEC will also provide reciprocal unbundling of its network to the ILEC at the UNE rates set by the state commission for the market. Telecommunications, by its very nature, requires continuing interconnectivity between providers. This continues to be true even when competition has fully matured in a market. Given this, it is in the public interest to require mutual interconnection and leasing obligations on all providers as competition progresses and matures, rather than eliminating ILEC obligations. *GCI currently offers to ACS unbundled access to loop plant that GCI has installed, at the same rate at which GCI leases unbundled loops from ACS.*

Retail pricing flexibility: Retail rate flexibility (upward and downward) would be made available to any carrier that has a retail market share of less than 65 percent in a service area. This proposal would give ILECs in competitive retail markets greater flexibility to raise and lower rates, more quickly, with less regulatory burden. An ILEC that asserts a "rural exemption" from competition, however, would not be eligible for rate flexibility; by claiming exemption, the ILEC is challenging the very basis of the competition that supports the rate flexibility.

Two conditions apply for retail pricing flexibility: (1) the rate for basic residential dialtone is capped at the existing level, with increases permitted only upon a showing of good cause; and (2) the state commission may disapprove rates that are not just and reasonable. In addition, rate flexibility would not be available for access, wholesale resale, or UNE markets, because the ILEC retains a monopoly in these wholesale markets that is not diminished by competition for local retail services. In Anchorage (as in other markets), CLECs are dependent on ACS for loops for the vast majority of customers. *Without continued access to these loops, local exchange competition would virtually disappear.*

Senator BURNS. Thank you for your testimony.

We have, now, Jack Rhyner, of TelAlaska, out of Anchorage, and thank you for making the trip today. We appreciate that.

**STATEMENT OF JACK H. RHYNER, PRESIDENT AND CEO,
TELALASKA, INC.**

Mr. RHYNER. Good morning, and thank you for the opportunity to address the Committee.

Mr. Chairman, if I could make only one point perfectly clear in my appearance before you today, it would be that there is a "perfect storm" gathering squarely in the path of the course we are on. If we do not quickly reverse course or, at the very least, change course, we will soon be in the eye of that storm with rural America isolated from the promise of the 1996 Telecommunications Act. And I am not referring only to the promise of the same advanced services currently available to most urban customers, but to the continued provision of the most basic universal services.

Congress gave equal weight to the two pillars of maintaining universal service and promoting competition in the Telecommunications Act. Yet, in practice, regulatory initiatives vigorously promote competition at the expense of universal service. We must begin to peel back the layers of regulatory fiat that threaten to unravel 67 years of history of universal service.

One place to begin is with an understanding of the two needs that USF supports—cost recovery for the rural LEC to provide basic telephone service in high-cost areas, and funding for social subsidy programs that provide and enhance additional services.

Universal Service Funding for rural LECs is not a subsidy; it is a cost-recovery mechanism. It is how the rural LEC recovers its actual cost of building and maintaining rural America's critical communications infrastructure. This part of the USF program is generally known as the high-cost fund.

The other side of USF, social subsidy programs, provides Lifeline and Link Up connections to the economically disadvantaged and discounted access to schools, libraries, and rural healthcare.

I point this out to try and restore a lost sense of proportion and priority. Throughout the process of implementing the 1996 Act, it has been the rural high-cost recovery mechanism that has been relegated to last place on the list of priorities. The social subsidy program of USF was fully funded. The non-rural high-cost support was fully funded. The funding for rural high-cost support has only been sufficient two of the last 8 years.

Without an adequate cost-recovery mechanism, critical infrastructure for these important additional services would not exist. There would be no reliable Lifeline and Link Up connections, nor would there be connections to provide access to schools, libraries, and rural healthcare providers.

I am very happy to hear that the Federal-State Joint Board on Universal Service is finally going to address the issue of a national standard for certifying ETCs. However, that same inquiry contains a whole list of proposals any number of which, if they were enacted, would provide less support to the rural LECs than they are currently getting under the Fund. Proponents of some of those proposals apparently overlooked the simple fact that the total amount of the high-cost fund is no more and no less than exactly what it costs to maintain the existing critical infrastructure.

In conclusion, the base upon which USF contributions will be assessed must be expanded or the future of universal service in rural high-cost America is in real jeopardy. Simply by adhering to the intent of the 1996 Act and adding all telecommunications service providers who connect to and make substantial use of the public switched network, we could expand the base considerably.

Congress should act to expand the base to more than \$200 billion by clarifying its original intent that all revenues, interstate and intrastate, should be assessed. This would also put an end to the ability of some carriers to arbitrage services between jurisdictions. And finally, the FCC should adopt a standardized set of minimum qualifications, requirements, and policies for State PUCs and the Federal commission to apply to potential and existing ETCs in rural service areas.

Thank you.

[The prepared statement of Mr. Rhyner follows:]

PREPARED STATEMENT OF JACK H. RHYNER, PRESIDENT AND CEO, TELALASKA, INC.

Introduction

Mr. Chairman, members of the Committee, my name is Jack Rhyner. I am the President and CEO of TelAlaska Inc. My company provides telecommunication services to some of the America's most remote rural locations, most of which are accessible only by air or water. Only three of the 25 rural communities we serve are on the road system. Our service areas range from above the Arctic Circle to well out into the Aleutian Islands, a distance roughly equivalent to that between San Francisco and Chicago.

I have 36 years of experience in the provision of rural telephony and am the third generation of my family to be so involved. I am appearing before you today in my capacity as the Chairman of the Government Affairs Committee of the Alaska Telephone Association.

Opening Remarks

Universal Service Funding (USF) is growing at an alarming rate. At the same time, a traditional source of funding is quickly evaporating, jeopardizing the integrity of a ubiquitous communications network upon which our Nation and her people critically depend.

Congressional action must be taken quickly to stem a tide of devastating regulatory and legal decisions. Those decisions, coupled with changes in technology and new competitive initiatives, could leave remote rural Americans totally estranged from the great promise of a good life in this great country.

Universal Service Funding (USF) springs from an assessment on revenues produced from the sale of interstate (long distance) services, a too-narrow and too-quickly-evaporating revenue stream.

The Federal Communications Commission (FCC) has made rural local exchange carriers (RLECs) even more dependent on USF by acting adversely on controversial court rulings about what constitutes *implicit support that should be made explicit* by substituting *universal service support* for *access charge cost recovery*.

State public utility commissions (PUCs) for the most part have done nothing but exacerbate the situation by failing to accurately assess the detrimental impacts to the *public interest* when granting *eligible status* to competitive local exchange carriers (CLECs) when such action *produces relatively little compensating benefit*.

The results of these actions are clear: USF is growing at an alarming rate. We must make at least the *cost recovery side* of USF sufficient and predictable as required by the 1996 Act. The relentless over-burdening of any resource—or the failure to provide adequate maintenance of a public resource—is known to economists as the *tragedy of the commons*. Unrestrained freedom in the commons results in ruin. It is not difficult to postulate real disaster in the very near future if action to find solutions is not started today.

Cost Recovery Versus Subsidy Elements

Congress gave equal weight to the two pillars of *maintaining universal service* and *promoting competition* in the Telecommunications Act. Yet, in practice, regulatory initiatives vigorously *promote competition at the expense of universal service*.

We must begin to peel back the layers of regulatory fiat that threaten to unravel the 67-year history of universal service. One place to begin is with an understanding of the two areas of need that USF supports:

- *cost recovery* for RLECs to provide basic telephone service in high cost areas, and
- *funding for social subsidy programs* that provide and enhance additional telecommunications services.

Cost Recovery for Basic Telephony

Universal Service Funding for the RLECs is not a *subsidy*. It is a *cost recovery* mechanism.

USF has been broken into smaller small pieces and labeled with new names like *high cost loop support* (HCLS), *long-term support* (LTS), *local switching support* (LSS). Most recently added to the list is *interstate common line support* (ICLS), which is the transfer of what was the legitimate cost recovery from access charges to USF.

Whatever the FCC calls it, it is only important to understand that, in total, *this mechanism is how the RLECs recover the actual cost of building and maintaining*

rural America's critical communications infrastructure. This part of the current USF is more generally known as the *high cost support* side of the Fund.

Social Subsidy Programs

The other side of the USF, the *social subsidy programs*, provides Lifeline and Link Up connections to the economically disadvantaged and discounted access to schools, libraries, and rural health care.

I point this out to try to restore a lost sense of *proportion* and *priority*. *Throughout the process of implementing the 1996 Act, it has been the rural high cost recovery mechanism that has been relegated to last place on the list of priorities.*

- The *social subsidy* part of the USF was *fully funded*.
- The non-rural high cost support was *fully funded*.
- The funding for rural high cost support *has only been sufficient two of the last eight years*.

Without an adequate cost recovery mechanism, critical infrastructure for these important additional services would not exist. There would be no reliable Lifeline and Link Up connections nor would there be the connections that to provide the access to the schools, libraries, and rural health care providers.

New Proposals Worsen the Outlook

Rather than seeking ways to insure that funding for the critical, underlying infrastructure in rural areas is sufficient, the Federal-State Joint Board on USF is now seeking comment on a list of proposals that can only erode that support further. Proponents are apparently overlooking the simple fact *that the total amount of the high cost fund is no more, and no less than exactly what it costs to maintain the existing critical infrastructure.*

Contribution Methods

Discussing contribution methodology without knowing key relevant factors is analogous to rearranging the deck chairs on the Titanic to stave off unforeseen disaster. Without knowing the size of the fund that must be supported or the base upon which the contribution will be assessed, it is impossible to test any methodology for long-term sufficiency and sustainability.

Since the size of the Fund is controlled by legislative mandate, regulatory fiat, and the legal interpretation of both, we should first discuss the base that will be assessed.

Revenue Methodology

The current methodology of assessing interstate revenues has been called into question because interstate revenue is in decline. There are a number of contributing factors to this decline:

- Arbitrage of jurisdictional separation by bundling local, intrastate, and interstate services is probably the largest contributor today.

Virtually all of the major wireless carriers offer bundled local and national long distance services for one flat rate.

- While not nearly as extensive, the transitioning of services to providers and technologies that are exempt from contributing also is becoming an ever-increasing problem.

An example of this would be the use of voice over Internet.

Congressional Clarification Would More than Double the Base

All other factors aside it is the Circuit Court of Appeals' *interpretation* of the 1996 Act that *limits the base of this methodology to only interstate revenues* that is at the heart of its trouble.

Congress could act to clarify the original intent of the 1996 Act that all revenues of any carrier providing interstate services should be assessed. This alone would increase the base from the mid-\$70's to over \$200 billion. It would end the ability of some carriers to escape contribution by arbitraging jurisdictional separation and it might well slow the growth of fund size, which I will address further on in my comments.

- *The use of the FCC's discretionary authority to exempt certain carriers that provide interstate services has played no small part in limiting the size of the base that could be and should be contributing to USF.*

Satellite, cable, some wireless and Internet service providers—even though they make extensive use of the public switched network—contribute nothing. These pro-

viders do not manipulate the content of the data they carry; they merely transmit interstate communication from one point to another. Therefore, they are *not information service providers* as defined in regulation. They are *interstate telecommunication service providers*. As such, they should be contributing to the Fund that sustains the network they extensively use to provide their services.

Their contribution would be nothing more than the fulfillment of the 1996 Act's mandate that *all providers of interstate services contribute on an equitable and non-discriminatory basis*. Whether using *revenues* or *connections*, this would be a sizable increase in the contribution base.

Connections Methodology

As I have already tried to point out—as reflected in comments filed with the FCC by the Western Alliance (WA), Organization for the Promotion and Advancement of Small Telecommunications Companies (OPASTCO), National Telecommunications Cooperative Association (NTCA) and in Senator Stevens own remarks while addressing an NTCA meeting only last Tuesday—*expanding the base of contributions is the real solution for a sustainable USF*.

Very simply stated, any provider that connects to the network should pay into the Fund that supports that network. Rather than fixing the underlying problems and expanding the base, the FCC is attempting to stabilize the base by choosing something to assess that is not declining. A severed artery cannot be healed with a compression bandage; it requires surgery to repair the damage. The number of connections—at least at this time—is still increasing. However, *the growth rate of connections will in no way keep pace with the growth rate of the USF*.

Of the three connections-based methodologies that have been noticed for comment, the one that splits contribution responsibilities between providers of interstate transmission and switched access services (proposal #2) would seemingly attempt to comply with the 1996 Act's mandate of equitable and nondiscriminatory contribution. The assessment is based on a fairly nominal monthly flat rate for single line residential connections and a doubling of that rate for single line business and wireless connections to generate in total roughly 40 to 60 percent of the total fund. The residual would be born by multiple line business and private line customers.

It is the recovery of this residual that may have unintended consequences especially if the Fund—and therefore the assessment—continue to grow. Sophisticated businesses will quickly realize that with up-to-date technology and connection through an exempt provider they can have a virtual private network and access to the rest of the public network without having to contribute. This inevitably results in yet another reduction in the contribution base.

Growth of the USF

Cost Shifting Impacts

FCC decisions to resolve interstate access pricing have shifted the local exchange carriers' revenue requirement—and corresponding cost recovery—from *access* to the *high cost* side of the USF.

- CALLS and MAG initiatives have shifted more than \$1 billion from access to USF over the last two years. The second phase of MAG will be implemented July 1, 2003 and another \$450 million will shift from access to USF.

The FCC's staff report on alternative contribution methodologies factors in a growth rate of two percent per year and the second phase of MAG. However, what is not accounted for is the resolution of the intercarrier compensation issue.

- A *bill and keep* regime will shift an additional \$.5 billion to USF. States will not be able to maintain an access charge system in the intrastate jurisdiction after the FCC has determined to move to *bill and keep* in the interstate jurisdiction.
- There is \$1.5 billion that is recovered through intrastate access. Some states may not have the ability to generate sufficient state Universal Service Funds to recover all of this revenue. Potentially, some of those \$1.5 billion may have to be recovered from the Federal USF. Thus, another \$1 billion is added to the size of the Fund—and maybe much more.

Portable Support Impact

What is totally being left out of the equation is the growth in USF from wireless CLECs being made eligible telecommunications carriers (ETC) to receive portable USF. *This part of the Fund is growing at an explosive rate* of from \$11 million in the first quarter 2002 to over \$100 million in the first quarter of 2003.

Most of these support funds are being paid to wireless carriers for large numbers of their existing low-cost customers.

- It is estimated that if all wireless providers were granted ETC status nationwide it would increase the size of the Fund by an additional \$2 billion dollars.

Continuation of this trend, in conjunction with the FCC's determination to make all interstate cost recovery explicit through USF, could drive the Fund to an unsustainable level.

There's one more critical factor to consider. State PUCs were given the authority to grant ETC status in the 1996 Act. However, with that *authority* came the *responsibility* to make an affirmative finding that such a grant was indeed *in the public interest*.

The public interest is a fairly nebulous concept in the absence of any definition contained in the Act. Such a determination of the *public interest* likely would at least contain:

- some sort of cost/benefit analysis,
- a structured, verifiable time line within which the CETC will provide some *new* service, or *expand* its service coverage, *to all customers* within a service area,
- and some *objective, verifiable* measurements to prove that the funds are being used for the intended purpose.

Left to discretionary interpretation, the vast majority of state PUCs—and the Wireline Competition Bureau, for that matter—has granted CETC status on little more justification than “it furthered the goal of competition.”

A serious investigation into the creation of uneconomic competition, supported by USF in the areas served by RLECs, would clearly show that it will not further the goal of universal service. The facts will show that the loss of even a small percentage of customer base may seriously impede the RLECs ability to continue to carry out their carrier of last resort responsibilities and may threaten their financial viability.

Conclusion

The base upon which USF contributions will be assessed must be expanded or the future of universal service in rural high cost America is in real jeopardy. Simply by adhering to the intent of the 1996 Act and adding all telecommunications service providers who connect to and make substantial use of the network we could expand the base considerably.

Congress should act to expand the base to more than \$200 billion by clarifying its original intent that *all revenues* (interstate and intrastate) *should be assessed*. This would also put an end to the ability of some carriers to arbitrage services between jurisdictions.

The FCC should adopt a standardized set of minimum qualifications, requirements, and policies for state PUCs and the Federal Commission to apply to potential and existing ETCs in rural service areas. I wholeheartedly endorse the proposed standards in the OPASTCO report *Universal Service in Rural America: a Congressional Mandate at Risk*.

Senator BURNS. Thank you very much. Those are interesting observations.

I want to ask you about public-interest funding on the rural high-cost areas. You say that those dollars are just meant to maintain the infrastructure of those areas, is that correct?

Mr. RHYNER. The total amount of the Fund—

Senator BURNS. Yes.

Mr. RHYNER.—the high-cost fund, is based on the cost of the ILEC already having constructed the total network. The problem comes when you try and get that number down to an individual customer. What you are doing is taking the costs for a complete network, and then dividing the number of customers in that and calling that per-customer support. Well, even if you lose that customer, that does not mean you have lost the cost for maintaining that entire network. And the ILEC is the only carrier so far that has been designated as carrier of last resort. So even in the case

where the customer substitutes a different service, the ILEC is still tasked with maintaining a network as the carrier of last resort.

Senator BURNS. Then how do we—in those high-cost areas, how do we foster competition if there is not portability?

Mr. RHYNER. Well, I would agree with Bill Gillis, in that we have to take a look at what it is that you actually want to do. If you want to foster the competition, if we want to have two different networks out there in rural locations, then we have to be able to provide enough funding to pay for both of those networks.

Senator BURNS. Mr. Meade, you are saying that new technologies—fiber, wireless, broadband—all of these things, have come, and that sometimes your collections on universal service are necessary to make some of those things happen. Had it not been for competition, and you still collected universal service, would you have installed those new technologies, and when would they be deployed?

Mr. MEADE. If it were not for universal service, in certain areas we would not be—

Senator BURNS. Maybe I have misquoted you. I have a habit of doing that every now and again.

Mr. MEADE. Well, I am sorry if I was not clear, sir.

Senator BURNS. Yes.

Mr. MEADE. One of the arguments that we have faced repeatedly from our competitors is that competition will automatically lower the prices to the end user and look, see what happened before. And simply because they happened at the same time does not mean there was a cause and effect. But lower prices in toll, for example, from Alaska, or to and from Alaska, was the result of new technology, not just because competition was introduced, but because people from Intel to NASA to Bell Labs to JDS Uniphase were working feverishly to make things cheaper, faster, more compact. And while this happened at the same time and as a result of competition in the Lower 48, it was not competition, per se, that is going to drive prices down in Egegik, for example. There are places out there where it costs us \$150 a month to provide local telephone service, and competition might drive prices toward cost, but out in Egegik, that is not a good thing.

So my concern is that we had people confusing cause and effect. We would, indeed, try to deploy whatever the latest technology is, the most effective, most efficient technology, and that in turn will keep the size of the Fund down. But we do have investors, and we do have to recover the cost of providing service, and that means if we invest in a technology at a particular point in time, we have to try to get that back.

Mr. Rhyner was telling me the other day that he has been trying to price DSLAMs, digital subscriber line access modules, to provide broadband to his customers. And a few years ago, the cheapest he could get to serve—what was it, eight to twelve customers, was \$40,000. He believes he now has a vendor that will provide him that same module for about \$2,000. It is not a—

Senator BURNS. Big difference.

Mr. MEADE.—it is not competition that is driving that down; it is technological development, economies of scale for manufacturers

in the Lower 48 for technologies and services that have been taking hold in broadband.

So I was simply trying to clarify what the cause and effect was on——

Senator BURNS. Well, I sort of——

Mr. MEADE.—cost drivers.

Senator BURNS.—I sort of looked at it as, you know, had it not been for competition or something to drive you to new services, new equipment, new way of doing things, that would not have happened had there not been some competition out there, because usually that is what causes us to make changes.

Mr. MEADE. Well, we have actually—I am almost reluctant to say this, but we have actually seen situations where it has been regulations and regulators who have prevented us from putting in new services.

Senator BURNS. Well, I think that is true. I would agree with some of that in some areas. But I also would agree that if there is robust competition out there in the marketplace, then even the universal service has a point of diminishing returns as far as the growth in the industry. You could also make that case in some instances.

Mr. MEADE. There are probably some areas of the country where that is true. I am not sure it is true in the extremely rural areas.

Senator BURNS. I do not think it is true in Alaska, and I know it is not true in Montana, but when you look at this theoretically, you know, in this town where we live, you know, it is 17 square miles of logic-free environment, we deal in theories here——

[Laughter.]

Senator BURNS.—most of which do not work——

[Laughter.]

Senator BURNS.—you know, when you get out on the ground. But, nonetheless, we deal in those.

All your testimony will be made part of the record. I think the Alaskan situation is really a great example of why we have the Fund, the weaknesses of the Fund, and why it becomes also very important as a fund. And it may be, in the Alaskan example, where we find out answers to make sure that the Fund is healthy, viable, and does what it is supposed to do.

I think there are some abuses in the Lower 48 that we have to take a look at. We are way out of whack as far as the intention of libraries and schools. I think some people have jumped on that thing and taken advantage of it, and there is terrible—I am hearing of terrible abuses. And we are going to—we may have to extend a hearing on that, but I am still going to stay with the idea that it is time that the three entities here—the legislature, the FCC, and the board of the Fund—should have some sort of a joint meeting and to come to some conclusion or at least identify the direction we should go to find a solution.

Your testimony here is very important today, let me tell you that right now, because I think it is a prime example and an argument made for all the entities that are working in Alaska for us to take a look at and to absorb. And I know you will have more questions as we go back and forth and even in coming out of what we think this meeting is very, very important.

So if you get a telephone call from some of us, why, we will be calling you and we want you to be very open, very frank, and very candid, as you have been here today, and I think we can find a solution to universal service. So that is what makes your contribution here very, very important today and one that I think will finally get us to—may take that giant step in finding a solution.

So thank you very much for coming, and we are going to keep the record of this committee open for a couple of weeks for comments.

On that, we are recessed.

[Whereupon, at 11:50 a.m., the hearing was adjourned.]

A P P E N D I X

PREPARED STATEMENT OF BRUCE RENARD, PRESIDENT, AMERICAN PUBLIC COMMUNICATIONS COUNCIL

The American Public Communications Council ("APCC") is a national trade association of over 1,300 independent (i.e., non-telephone company) providers of payphone equipment, services and facilities. Of the approximately 1.8 million payphones currently deployed nationwide, approximately 500,000 payphones are operated by independent providers and the remaining 1.3 million payphones operated by the incumbent local telephone companies.

This statement explains the role that public pay telephones have played in contributing to "Universal Service" and describes how the Federal Communications Commission's recent universal service assessment system proposals would adversely impact that role. This statement also offers thoughts on the future relationship between payphone service and the Universal Service Fund.

The Unique Role of Payphones in our Communications Network

Payphone service is an "on demand dial-tone/per use" wireline, high-quality communications service readily available to all members of the public twenty-four hours a day, seven days a week, 365 days a year. Users are not required to make an initial investment in equipment, await activation of the service or pay recurring monthly charges. Any member of the public can place a call anywhere at any time. Users have the option of paying for calls with coins or by use of calling cards, prepaid cards or other access code arrangements.

In many instances, payphones provide access to the communications network at no cost to the consumer. Emergency 911 calls are available at all the payphones in the country free of charge to the caller, around the clock. Users also can place calls using 800 and similar "toll free" numbers at no charge to the caller at the payphone. These numbers provide a variety of services to callers including access to public services such as: Social Security; Women, Infants, and Children Nutrition (WIC) programs; the Internal Revenue Service; Veterans Benefits hotlines; and domestic violence hotlines.¹ By providing all Americans, no matter what their income level, with readily available, affordable and reliable access to the telephone network, including free access to 911, 800 and other services, the public communications sector (also known as "payphone service") constitutes a vital contributor to universal service on a national scale.

As Congress recognized in mandating the FCC to encourage widespread deployment of payphone service, payphones are important to all Americans regardless of their income or where they reside. Users of wireless service need ready access to payphones when their wireless phones are out of a service area (such as in many rural areas), lose battery power or are not otherwise available for use. Additionally, the significant remaining percent of Americans that do not own wireless phones deserve readily available access to the communications network when outside their homes.

Payphone users exist in every strata of society and in every neighborhood and region of the country. They rely on widespread access to payphones to meet both every day and critical needs. In addition, payphone service is vitally important to low income Americans, particularly the more than five and a half million without a home phone. Payphones are also critical in rural areas where a significant number of poor Americans lack basic home telephone service. Not only is the percentage of poor rural Americans without phones greater than in other areas but fewer citizens in rural America own wireless phones and wireless service is often not available in rural areas. Those without home or wireless phones need access to payphones not only in the communities in which they live but also in the many communities in which they commute to work each day.

¹A recent study shows the large percentage of "social service" calling that takes place on payphones.

The value of readily available, reliable, high-quality public wireline service cannot be underestimated as the events of September 11 clearly demonstrated. New Yorkers were lined up to access payphones when other forms of communication were unavailable. In these uncertain times, the public needs to know that in case of emergency whether local, regional or at the national level, they have access to dependable, reliable and readily available payphone lines through which they can contact their families, alert authorities, or access information.

The Current Situation: Decreasing Payphone Deployment

Delays in resolving payphone revenue issues, such as the compensation payphone service providers receive for non-coin calls, and a range of regulatory uncertainties have resulted in significant erosion in the number of payphones deployed in the Nation. At the same time, the expansion of wireless services since 1998 has had a dramatic effect in reducing the overall volume of calls made at payphones. As call volume has declined, payphone service providers have been under pressure to remove payphones from locations where they still are needed by the public but may no longer attract a sufficient number of calls to offset costs. Payphones with as many as 250 to 350 calls per month have been, or are at high risk of being, removed from service as unprofitable. If a payphone with 250 calls a month is removed, callers must find some other way, or place, to connect to our communications network or must wait to make these calls. Unfortunately, this holds equally true for ordinary as well as emergency calls.

According to data published by the Federal Communications Commission, between March 2000 and March 2001 the number of payphones in the U.S. decreased overall by approximately seven percent. While Commission data is unavailable for the period since 2001, data available from states that track payphone deployment indicates that the decline in payphone deployment is accelerating. For example, in 2002, West Virginia payphones decreased by about 11 percent compared with an 8 percent decline in 2001, New Jersey had a decrease of 23 percent in 2002 and California had a decline of about 10 percent. These figures comport with APCC's estimate that over half a million phones have been removed from service nationwide, in the past three years alone. And looking ahead, the announcement by BellSouth that it plans to exit the payphone market at the end of 2003, will almost certainly have an impact on the 145,000 payphones that it has previously operated throughout the southern United States.²

Current Universal Service Fund Payphone Assessments and the FCC's Proposed Connections-Based System

Under the current revenue-based system, payphone service providers are assessed by the Universal Service Fund (USF) on the basis of their revenues from interstate coin calls. In addition they pay local exchange carriers a monthly USF surcharge. Although calling patterns vary from phone to phone, the average monthly payphone universal service assessment is approximately \$.60 per month per payphone line (\$.50 for the local exchange carrier surcharge and \$.10 for interstate coin calling). Moreover, PSPs have no rational way to pass through these assessments to customers. These assessments, contribute, on a percentage basis, a very small amount of support to the USF, but constitute a significant burden on payphone deployment and the unique form of universal service that payphones provide. PSP assessments, on both a direct and pass-through basis, contribute approximately \$13 million, or approximately two-tenths of one percent of the \$6 billion USF. Importantly, payphones do generate substantial revenue for the IXC's, which are able to recover these costs from customers, and are then able to make significant contributions to the USF fund for dial around calls made from payphones. The net effect of payphone line assessments on PSPs is that universal service, in the broad sense of broad public access to the network for voice grade services, suffers more than it would benefit if payphones were not accessed.

If, however, the Commission determines in their current rulemaking that payphone lines are to be assessed, the lines should be assessed a rate that reflects payphones' role as a "lifeline service," the Congressional mandate for widespread de-

² If the FCC delays in responding to the petitions filed by independent PSPs and Regional Bell Operating Companies to update the current dial around rate, which was established based on a cost recovery model, that will result in a further decline in payphone deployment. These petitions, which use virtually the exact cost recovery methodology approved by the Court of Appeals, clearly identify that the existing rate is significantly below a reasonable and compensatory rate for these non-coin calls. While regulatory delays are problematic for all businesses, they are particularly difficult for the many small businesses that comprise a significant portion of the independent payphone service provider industry. These businesses run on small margins and dial-around compensation payments comprise a significant portion of their revenue.

ployment, and payphones' unique characteristics (*e.g.*, a very small number of coin-paid interstate calls from which to recover universal service contributions, predominantly one-way outbound calls, and an access line that is shared by many public users). Just as the Commission has proposed a lower connection-based rate for pagers than for other categories of telecommunications services, so too should it establish a lower rate for payphone lines. Regardless of what long-term action the Commission adopts on universal service assessment methodology, the assessment rate, if any, for payphone lines should, at a maximum, be no higher than the current average level of payphone line assessments (*i.e.*, no higher than a total assessment of \$.60 per line per month).

An FCC decision that could result in raising the rate paid by payphone service providers would greatly accelerate the removal of payphones. To help stabilize the deployment of payphones, the FCC can and should refrain altogether from burdening payphone service providers with these per-line charges.

Conclusion

PSPs provide a readily available, reliable, low cost connection to the communications network. This is a valuable service that should be exempt from universal service fees. If the FCC decides not to exempt payphones, they should look carefully at any assessment levied. Any assessment that would increase costs beyond the current average \$.60 per line charge would by necessity be absorbed by these small businessmen who are unable to pass on these costs. At a time when consumers are already experiencing a diminution in services, any increase in costs would further accelerate the decline in available payphones. If fewer payphones are available to pay into the Fund, increasing the assessment would not ultimately meet the goal of increasing the size and viability of the USF. Universal Service "on the street" for our citizens will suffer measurably in both respects.

